

Funding Circle Holdings plc

HY20 Results

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Transcript



Samir Desai: Welcome to the Funding Circle First Half 2020 results presentation. It's been an extraordinary period for Funding Circle, but I feel really proud of the huge difference that we've been able to make to so many small businesses during this period.

Samir Desai: We started Funding Circle 10 years ago to really help small businesses access funding from alternative sources to banks. And our online only platform model is really delivering for them during this time of need. Our model is also benefiting from some really powerful trends. Across many industries, there has been an increase in the adoption of digital services, and we are seeing that same trend in online, small business lending. We also see the interest rates are lower and we expect them to be low and possibly even negative for a long time. This is attracting record levels of institutional funding onto our platform who are looking for yield and looking to fund small business borrowers.

Samir Desai: We feel that we have successfully navigated the very difficult conditions from COVID, and the business is well positioned to take advantage of these trends in the future. In the first half, we saw very strong demand from borrowers and investors. In the UK, we have become the fifth largest CBILS lender with close to 20% market share of approval since we joined the program. We've approved £1.2 billion of loans and originated £850 million. And our originations in June to August have been up more than 30% year on year. In the US, we were approved to the PPP program and we've approved over a billion dollars of loans and originated around \$500 million.

Samir Desai: We feel we're effectively managing our loan book during this period of extreme stress. Following an initial spike, the number of borrowers missing payments is now below pre-COVID levels, missing payments for the first time and more than 90% of borrowers are making payments. Investor returns are resilient, and after applying our central COVID stress scenario, we expect all UK cohorts to deliver positive net return and all US cohorts except 2019.

Samir Desai: Our new instant decision lending technology is really transforming the small business borrower experience. Representing 40% of the applications in the UK. And these allow borrowers to apply in just six minutes and get a decision within nine seconds. From a P&L perspective, we saw strong income growth. Total income reached 101.2 million, which was up 24% year on year. And our free cashflow improved to a negative 9.6 million from a high level this time last year.

Samir Desai: The business continues to be very well capitalised with a strong balance sheet of around 217 million of net assets. Our adjusted EBITDA was a negative 84.1, which was primarily due to the impact of COVID-19 on the valuation of loans we were holding for sale, which Oliver will talk through and explain later.

Samir Desai: The Funding Circle model has proven itself to be incredibly resilient during this time of stress. We connect up thousands of small business borrowers with thousands of investors to allow both to get a better deal. We have originated over £10 billion of loans since our platform, which is cumulatively two times as large as when we took the business public two years ago. And we do genuinely believe that our ability to very quickly aggregate huge

amounts of capital and distribute that to small businesses has been a real source of strength and a real validation of our business model.

Samir Desai: There were three phases of activity in the half. We started the year very strongly in January and February with a clear focus on improving conversion and keeping net returns attractive for investors. Originations were at the high side of expectations, driven by the demand for SME loans in the UK following Brexit and the general election, but also in the US, we were at the highest levels of origination for 12 months. And we completed the build of our instant decision lending technology. And it started to test that in the market. Our January to February originations were around 425 million.

Samir Desai: As COVID hit, we adapted very, very quickly and significantly tightened our credit criteria, which brought down originations, but protected returns for investors, as we sought to understand what was happening in the economies we operated in. We successfully transitioned all of our workforce to remote working and dramatically increased our collections resource and capabilities to help borrowers who requested payment plans.

Samir Desai: We also became the only lender to become accredited to both the US and UK government programs. We were one of the first lenders accredited in the US and the first fintech accredited in the UK, and in May to April, our originations were lower, at about 147 million as we transitioned.

Samir Desai: And in the last phase, which has really lasted in May and June, but also in Q3, I'm really proud of how the amazing efforts from our team and how quickly we've been able to really ramp up originations to help thousands of small businesses. We launched PPP loans in the US and CBILS in the UK. We were able to very quickly close record levels of funding to meet SME demand, which is really down to the long track record that we've been able to develop, which gave a lot of institutions, the comfort to increase their commitments, and also put more money for new investors to join our platform, to get money to small businesses.

Samir Desai: We've achieved record levels of origination, and actually in the UK from June to August, we've continued to show an uplift of more than 30% year on year. And so over that period, our major June originations have been around 539 million. So I'm just going to hand over to Jerome, who's going to talk about the SME credit environment.

Jerome Le Luel: Hello, I am Jerome Le Luel, I'm the Chief Risk Officer at Funding Circle. I've been with the company for five years and in charge of risk management globally. And prior to that, I spent 20 years in financial services in similar roles. My previous position was with Barclays. I was the Chief Risk Officer of Barclaycard, and there, I managed a portfolio of £40 billion of assets through the 2008 crisis. And I would say that this experience, which has been extremely rich, is now very helpful to help me and the team that we're getting this new crisis.

Jerome Le Luel: So what have we seen so far with the COVID crisis? Well, when the lockdown happened in late March, we experienced a surge of borrowers reaching out to ask for payment plans. They were typically quality borrowers who had never missed payments before. They were just concerned with preserving cash for the business at a time of high uncertainty.

Jerome Le Luel: So we did enroll quite a few of those borrowers on payment plans. And what you can see on this graph here is the index flow of those customers who are moving from making payments to not making payments over time. And you can see that we reached the peak around late April. And since then, this has come down and from July onwards, we are actually now running at a level of new entries into those plans that is below the pre-COVID level. On the left-hand side, you see the experience we've had in the UK, on the right-hand side, what we've seen the US. The two follow a very similar pattern.

Jerome Le Luel: So what has happened to those customers who did enroll on plans? We deployed a lot of resources to help them, increase staffing in collections and recovery teams, offering different versions of forbearance plans, making sure we were advising them in the right way to take advantage of government support, being furlough or government schemes, government backed loans, and our borrowers have made good use of those tools to help their business at the time of crisis.

Jerome Le Luel: The good news is that as those customers exited their plans, which was typically a three month plan, the vast majority of them have restarting making their normal contractual repayments. You can see on the graph a snapshot of the UK and US portfolio as of the end of August. And it shows that in the UK, more than 90% of borrowers are now making their full contractual payments every month. A few percent are still on a plan that has not reached its term. And we only have around 7% of borrowers who are not making their payments, and we're helping them finding solutions to get back on their feet.

Jerome Le Luel: In the US it's a similar pattern. The percentage of customers making payments is above 80%, we have a larger proportion of borrowers in the US who are still on a payment holiday. This is because of the way the plans were structured and the timing, but these customers are due to exit their plan in the coming few months and we hope that the majority of them will restart paying like we've seen in the UK. And it's less than 10% of the borrowers in the US who are not paying at this stage.

Jerome Le Luel: So overall, I would say the recovery to payment has been better than what we could have expected from a population in financial difficulty, which again, give us the evidence that those customers were quality borrowers to start. They just had temporary issues. And they've managed to get back on their feet and be supported by the government actions. It looks like the vast majority of them are going to recover.

Jerome Le Luel: Now, what does this mean for the longer term? It's obviously quite difficult at this stage to tell how this recession is going to play out. We only have the beginning of it. So if you take a look back at what recessions typically mean in terms of credit stress, you can represent that in a graph like you have on this page, where the recession was trusted into an index of multiplication of the baseline monthly credit losses.

Jerome Le Luel: The green line here shows an environment that is benign, that's what we assume pre-COVID. The black line shows what the stress would be if you use the Bank of England, 2019 stress test scenario. And this is a very similar representation to what the 2008 recession actually did in the UK. So credit

losses ramp up over the normal baseline over 15 months to a peak of around 2x, and then gradually de-stress over the following three years.

Jerome Le Luel: Well, in this recession, we think the pattern will be a bit different. We expect the initial spike to be sharper and higher. That's something we've already seen. And then there will be a de-stressing and a longer tail, which will be obviously dependent on how the economy is faring.

Jerome Le Luel: So looking at our portfolio and its composition, as of today, we've been able to create a forecast, which we think is quite reasonable at this stage. And it is represented by the orange curve on this slide. So we do see the spike going maybe up to 3.5x over the baseline, and then very fast de-stressing. And we're very much now at the point where we're seeing the de-stressing as those customers, the new entries into not paying, have come down and we see people getting out of plans and restarting paying. But there is some unknown around how fast it's going to actually de-stress and with the dependency on the ongoing government support and how logged on measures might evolve.

Jerome Le Luel: In the longer term, it's hard to tell. We've assumed in our scenario, which is our central scenario here, that the UK economy would probably experience a recession similar to 2008. That's our base assumption. The way this would translate into losses is a bit different from 2008, because some of the defaults have been brought forward. So this cleansing effect means that we should be fewer defaults down the road for the same difficult economy, hence why the orange curve is below the black curve in the two years.

Jerome Le Luel: Overall, this orange curve is a stress multiplier of 1.4x over the period, similar to the Bank of England stress test, but because the losses are brought forward and because our loans are amortising, it does translate into higher overall losses than the 2008 recession would have done, probably around 2x. And so overall, it's a scenario that is more pessimistic than the 2008 recession.

Jerome Le Luel: We then take on this stress scenario, the orange curve, and using this, we've been able to recompute the expected returns by cohort of loans originated in the past. So looking at the actual so far, and then making a projection going forward, we can run the expected annualised return for our investors who are exposed to these various cohorts of loans.

Jerome Le Luel: We've always at Funding Circle strived to protect the capital of our investors and make sure that in a stress situation, investors would recoup their original investment at the very least. We've built buffers in the pricing of loans, in the credit parameters to ensure there was enough resilience in the portfolio. And I'm quite pleased to see that through this estimation we've done using the latest data we have, it looks very likely now that our investors in the UK are going to earn positive returns on their investment despite the stress.

Jerome Le Luel: If you look at it by cohort, you can see that the older cohorts are going to experience less stress than the recent cohorts. The black bar shows the estimation of return we had made back in January before knowing about COVID. The blue bar shows the latest estimate we have in factoring the COVID stress. And you can see that there is little difference between the blue

and the black bar on the older cohorts, but on the more recent one, the gap in yield is bigger. You should expect the yield to go down when losses are higher, but you can see that the blue bar remains positive, which is a good thing.

Jerome Le Luel: The reason that the recent cohorts have a bigger difference in yield is because they have more to go. They are less amortised, so they are more impacted by the current crisis.

Jerome Le Luel: In the US it's a very similar story. The older cohorts are going to deviate less than the recent ones. There is one cohort, 2019, where we think it's going to go slightly negative. And this is due to the fact that the loss coverage was not as rich in the US as it was in the UK.

Jerome Le Luel: The more recent bookings of 2020, whether they are pre the government programs or the government programs themselves, CBILS in the UK, PPP in the US, are expected to deliver positive returns because we've been able to tighten pre-government programs and then government programs provide guarantees that obviously make them very resilient to our investors.

Jerome Le Luel: So, overall, I think this is a proof that the way those loans were calibrated was very reasonable. And I'm pleased to see that some of the investors who did invest in the unsecured loans pre-COVID are now also willing to invest in the government program loans we offer today. And for me, that's a strong sign that they trust that we are taking care of their assets very well, and that we're going to carry on doing that going forward. And now I'm going to head over to Oliver White, our CFO.

Oliver White: Thank you, Jerome. I'm very happy to be joining you all at my first set of Funding Circle results, and I'm very excited about the future here at Funding Circle. We have just discussed the actual and forecast impact of the pandemic on our SME borrowers and the impact returns to our investors. Turning now to the impact on Funding Circle's balance sheet.

Oliver White: As you know, Funding Circle funds its 3.7 billion loan book for a variety of sources: retail of individuals directly purchasing fractional loans, national entities, such as the British Business Bank, which is a UK government's investment bank, private and public funds, institutional investors, directly purchasing whole loans. Additionally, in 2019, we launched new investor products to aggregate loans in warehouses for substance sale, as bonds via securitisation. We did this to widen the universe of investors that could access the loans, and indeed successfully added 30 new investors, but it's also an efficient mechanism to provide working capital to build an infantry of loans.

Oliver White: 759 million of these bonds and warehouses are consolidated on the balance sheet for accounting purposes. This represents about 20% of total loans under management. These loans are holding bankruptcy remote vehicles. Funding Circle's exposure therefore was limited to its investment in this SME loans. As of June 2020 Funding Circle's investment was 110 million. These vehicles are subject to regular assessments of the value. It should also be noted that Funding Circle's negligible balance sheet exposure to the other sources of investor funding.

- Oliver White: Diving deeper into the 110 million investment, there were four main types of vehicles in which Funding Circle invest its capital in SME loans, some of which are intended to be temporary. These vehicles have very different risk dynamics and therefore impacted by economic stress and the pandemic in different ways. And clearly the speed of the impact of COVID-19 on the wider economy was unprecedented.
- Oliver White: Firstly, Funding Circle is acquired by regulation to retain a 5% vertical slice of any securitisation issuance. This has an equal participation in all classes of bond, resulting in a relatively low impact from COVID-19. Secondly, there were a small amount of other investments comprising seed investments, and private funds, and participation investment in the UK CBILS Program. These also have equal participation or loans, the impact is again low.
- Oliver White: Thirdly, the warehouse structures combine Funding Circle equity to bank debt. The intent of the warehouses is to aggregate loans prior to securitisation. This is effectively our inventory of loans. When COVID hit the UK warehouse with 100% of capacity with a planned securitisation in April, and the US warehouses were at 30% of capacity following a successful securitisation of loans in January.
- Oliver White: Due to the impact of COVID, we were unable to securitise these warehouses when originally planned. Funding Circle's exposure in these vehicles is to the loan book as a whole, but the debt is senior, which means our equity's more exposed to change in the valuation of the loans.
- Oliver White: Finally, once you have securitised loans we'd have temporarily retained the horizontal tranche with the intention to sell these loans once they season. We did this as we were a new issuer, and we wish to establish some early proof points on performance. Due to the structure of securitisations, these tranches have the potential to earn greatest returns but also absorb losses first. This is why they have a higher COVID-19 impact than the vertical tranches. The timing of the pandemic meant it was not feasible to dispose of these horizontal tranches in H1.
- Oliver White: Turning now to the changes in these vehicles in H1. Firstly, talk it to the chart on the left hand side of the slide and considering what principal Funding Circle has built in these vehicles. As at the end of December 2019, we'd invested principal of 134 million of equity. As shown in the chart, 34 million more was added, primarily being the increased utilisation of the warehouses.
- Oliver White: We extracted nine million of cash out of these vehicles, which leaves us with a principal of 159 million as at 30th June 2020. Secondly, the chart on the right-hand side shows a balance sheet valuation of these vehicles. This is consistent with a central stress scenario outlined earlier by Jerome. The balance sheet view shows 145 million as at December 2019, this includes the interest earned in 2019, which has been reinvested into these vehicles.
- Oliver White: The additions are 34 million on the same as the previous chart, the income earned and a fair value adjustment combined to an investment adjusted EBITDA of negative 60 million, which is what's seen on the face of the P&L. In H1, we generate an investment income of 36 million from these vehicles, the evaluation of fair value resulted in an adjustment of negative 96 million, primarily due to the economic stress of COVID-19.

Oliver White: After the nine million of cash extracted we are left with a valuation of these assets of 110 million. It should be noted as an element of unwind in the fair value, as income becomes crystallised in the investment income line and fair value reduces, the fair value adjustments seen in Q1, in other words before the pandemic struck, was negative circa 11 million.

Oliver White: Should these vehicles be held to maturity, we would expect total future cash flows of circa 149 million. The impact of the COVID-19 economic stress is concentrated on the assets, and the warehouses, and the horizontal securitisation retention, both of which we intended to sell. The timing of COVID-19 impacted our ability to sell on these assets and the timescales originally intended, and the speed of the impact of COVID-19 to the economy was unprecedented with the speed from peak to trough much faster than seen in the 2007-2008 economic crisis.

Oliver White: The balance sheet valuation for the vertical securitisation tranche is 18 million with negligible fair value adjustment. The other investments have a valuation of 16 million, again, of negligible fair value adjustment. The warehouse has generated 15 million investment income in the half with a 35 million fair value adjustment, and a balance sheet valuation of 66 million. The principal in the warehouses was 18 million.

Oliver White: The horizontal securitisation tranches with a first loss risk characteristics generated 21 million of income for fair value adjustment of 61 million, and we have a balance sheet valuation as of June of 10 million. 45 million, the principal, had been invested. It is still our intention to sell these assets once markets are normalised.

Oliver White: Funding Circle continues to maintain a strong balance sheet, net assets of 217 million. As discussed, retain 110 million of investments and warehouses securitisations and the other vehicles, and as noted it's still our intention to sell these assets once markets have normalised. 107 million net assets are deployed against the trading business, including 74 million of cash and cash equivalents.

Oliver White: Turning now to the group's financial performance. Loans under management increased by 5% over 3.7 billion. This increase was seen in all geographies with a constant currency, the UK growing 5% and the US 3%. Originations totaled 1.1 billion, down 7% year-on-year, primarily due to the lower levels of activity in March and April as the business adjusted to the pandemic and adapted to the SME government guarantee programs. As Samir noted, January and February provided a strong start to the year in both the UK and the US, and May and June were record months for origination. Origination growth was up year-on-year in February and again in May and June.

Oliver White: Total income growth was 24%, supported by the contribution of the investment income. In other words, the income from the investment vehicles discussed a few slides back. Consistent with our presentation of adjusted EBITDA, we here on the right hand side of the slide show incomplete operating activities. So the transaction fee income from originations, the servicing fees, and other fees, and the income from investments, so investment income less investment expense.

Oliver White: We launched the new investor products in the second half of 2019, so as you can see on the right-hand chart there was limited investment income generated. Since then, investment income has grown strongly. In H2 2019, investment income was 19.1 million and continued to grow to 36.4 million in the H1 2020. Operating income was reduced to the lower levels of origination activity in March and April. The CBILS loans have similar economics to a core lending product, but slightly lower transaction fee, and slightly higher servicing fees.

Oliver White: PPP loans have a transaction yield of about 2.5% as we discussed on the July, the eighth announcement. Within operating income, transactioning came what reduced to the lower levels of origination activity in March and April. Transaction yield is slightly down predominantly due to the nature of the government support or loan schemes in the UK and the US. Servicing yield was slightly impacted due to the increase in borrowers and collections, including payment plans. Retail investors do not pay servicing figures, and borrowers are not fully up to date.

Oliver White: As can be seen in the chart on the left hand side of the page, the increase in total income was seen across both the UK and the US. Developing markets income reduce 39% in line with changes in the business model previously announced, and the impact of COVID-19 on these markets. We re-structured the businesses and changed the model to originate loans for other lenders in the market, rather than for our investors. The re-structure being successfully completed and in line with guidance set out at the full year results.

Oliver White: Due to the impact of COVID-19 on local government responses, we were to hold back initial investment in the new model and this has affected growth, especially in the Netherlands. Total income here excludes the fair value adjustments, total income less fair value adjustments subtotals to net income as shown on slide 21. The adjusted EBITDA loss is driven by the COVID-19 impact on fair value we've previously discussed. There was a strong improvement in free cash flow. The chart on the left hand side shows the adjusted EBITDA split between the contribution of the operating activity and the investments.

Oliver White: The operating activities adjusted EBITDA slightly from negative 20.7 million in H1 2019, and negative 17.3 million in H2 2019 to negative 24.4 million in the half. This is primarily driven by the reduced origination activity in March and April, and its impact on transaction fees. The investment income adjusted EBITDA reduced from 9.5 million positive to negative 59.7 million due to the fair value adjustments partially offset by the increased investment income.

Oliver White: Free cashflow continues to improve from negative 28.1 million in H1 19 to negative 21.3 million in H2 19 to negative 9.6 million in H1 of 2020. This is due to continue improvements in the cash generating components of adjusted EBITDA partially offset by working capital movements. Operating costs are down 10% year-on-year falling from 112.7 million to 101.7 million and are expected to fall a further 15% in H2 over H1.

Oliver White: In H1 this was primarily driven by the reduction in marketing, with marketing falling to 22% of total income down from 43% in the prior period. The fall was driven by reduced activity levels in March and April, the revised nature of

marketing to support government loan schemes, the broader downward pressure on marketing costs due to broader economic conditions, and importantly the ability of Funding Circle to use marketing as a counter cyclical lever.

Oliver White: Operating costs will further decline in H2 as a benefit of the previous announced re-structures and developing markets and the US business were realized. Funding Circle's operating loss is impacted by the significant fair value adjustment driven by COVID-19 and by one-time exceptional costs. The exceptional items are the five million re-structuring charged for the developing markets revised business model, and the 12 million for the non-cash write-off of the Goodwill associated with the acquisition of the US business in 2013, related to the re-structure of the US business.

Oliver White: To summarise the previous slides as they feed into operating loss, fee income, or the operating income, has been impacted by a slowdown in equity in March and April with slightly reduced transaction in servicing yields. Loans under management is up and originations are very strong in the first and last parts of the half. Total income is up 24% supported by the increase in investment income. Net income is significantly impacted by the COVID-19 driven fair value adjustment. Operating expenses excluding exceptional items for year-on-year. In total Funding Circle's operating loss for the half pre-exceptional is 96.6 million and post-exceptional is 113.5 million. I would now like to pass over to Samir.

Samir Desai: Thank you Oliver. Just wanted to talk through our views on the overall market environment and then finish on the outlook. So COVID has been an extreme stress and we wouldn't have wished for a recession, certainly one as bad as COVID-19, but we do really feel that there are some powerful trends that are emerging from this that will really benefit Funding Circle.

Samir Desai: First of all, government support for small businesses across all of the economies we operate in, and pretty much every country in the world, really demonstrates the strategic importance of small businesses to economic growth. Governments have stepped in to help support small businesses and lending to them in a way that they haven't done for say consumer lending, or mortgage lending, or other products. That's reflected in the \$520 billion of loans borrowed by small businesses during the lockdown in the US, and the £50 billion borrowed by SMEs in the UK. So whilst we're really proud of the impact that Funding Circle has been able to have, you can see that there's still a huge addressable market for us to be going after.

Samir Desai: There's been a significant acceleration in the adoption of digital activities, online purchasing, not just in our industry but across all industries, and we really do see that trend emerging in small business lending. We've seen a 2X increase in the amount of searches for business loans online, and we really do believe that as the largest online small business loan provider across our markets we're really in a unique position to take advantage of these different trends.

Samir Desai: Interest rates are low, they've been cut low, and we expect them to stay low for a long time, and that's certainly reflected in yield curves. In fact, we may even see a period of negative interest rates in the UK and US. What this means is that we're seeing incredible amounts of demand from institutional

investors to purchase loans that were originating because they really provide access to yield that isn't available on most traditional fixed income products. That's reflected in the £1.25 billion of investor capital that we've managed to raise so far since the beginning of COVID to lend to small businesses in the UK and US on our platform. There's been huge demand from these institutions to access this asset class, and we expect that to continue and to benefit from that.

Samir Desai: Finally, more small businesses have actually borrowed money. Actually, in most economies the majority of small businesses typically don't access borrowing partly because they don't need to, partly because they don't understand the process as well. Whereas the vast majority of now have experienced borrowing, and we expect them to actually continue to, now that they've tried it, to actually continue to do so in the future as a way to manage their business.

Samir Desai: That's reflected in the fact that 55% of small businesses expect to require access to finance in the next six months, so this is really an area where there will be an ongoing need, and we're in a prime position to really help those small businesses take advantage. Our unique model we feel is really well-placed to deliver these government programs, so in the UK CBILS loans have an 80% guarantee and offer loans above £50,000. We've approved £1.2 billion of loans since we became accredited at the beginning of May, and originated £815 million of loans, and since joining the scheme we're the fifth largest CBILS lender after the big four high street banks.

Samir Desai: Our market share of the number of approvals is 20%, which demonstrates the huge impact we've been able to have in a very short period of time, and really the big impact we've been able to have. We've seen very strong investor demand to purchase loans as I've talked about, we're fully funded to meet our CBILS capacity, and our funding has been agreed with multiple different institutional investors, and that includes banks, asset managers, insurance companies, number of companies really placing their faith in our data-driven advanced credit assessment, and our ability to distribute and process loans at a very large scale.

Samir Desai: The graphs on the right just demonstrate the real breadth of the lending that we've been able to facilitate, I'm not picking on anything in particular but across all of the regions of the UK, across a variety of different sectors, we've really been able to help a lot of small businesses and have a huge impact. In the US, we are well positioned for the second half, we started the year very strongly, our January and February originations were the highest they'd been for 12 months, and in response to COVID the US government introduced the Paycheck Protection Program.

Samir Desai: The way that scheme works is similar to the UK furlough scheme, whereby the SBA will forgive loans if the funds are used to pay eligible expenses such as payroll costs, or employees. These loans are 100% guaranteed and we're accredited for the programs at the end of April, and had a very strong May, June, July, and August as the schemes carried on, and the current scheme is currently paused at the moment.

Samir Desai: We've approved \$1 billion of loans, and we've originated around \$500 million of loans as at the 20th of September. You may remember in July that we

introduced changes in the US business to accelerate the path to profitability, this included centralising our US technology team in the UK, and moving our sales and marketing teams to our Denver office with workforce reductions in aggregate resulting in a net reduction of 85 roles. The re-structure has gone well, and the team are very focused on delivering a strong second half.

Samir Desai: We have two areas of priority for the second half, at the moment the PPP Program is paused and we're awaiting feedback on whether there will be an extension of that which has the support of both the Democrats and Republicans, although the impact of an extension on PPP has not been included in the outlook that we'll talk about later. And we're focused on restarting our core lending product and helping more borrowers, including adding other lenders to our marketplace, including SBA 7(a) guaranteed loan providers.

Samir Desai: What I'm really excited about, and what we've been able to really roll out this year, is our instant decision lending technology, which is really having revolutionary results for small businesses, and this is something we've been working on for a very long time. It really takes advantage of the 10 years of experience that we've been able to accumulate over a million applications, huge teams that we have in engineering and data analytics that really been focused on processing this. And we've got the technology to a point where we've been able to process 40% of our loans in the UK through this platform. It takes, on average, just six minutes to apply, and borrowers get decisions in only nine seconds.

Samir Desai: We've also been really pleased with the initial results monitoring the credit performance of these loans, which we can see from both pre-COVID and during the COVID environment. So really, this is a really exciting development for us. It really game-changes the platform. At the moment, operating for loans below a hundred thousand, but one that we can roll out progressively over time, and really allows us to build a lot of new products and integrations on top of this technology, that will really allow us to take Funding Circle to another level. So really excited to be able to talk about those innovations in the coming months and years.

Samir Desai: And this instance of lending technology is really making a big difference to small business borrowers. Borrowers like Debbie Leon, who set up Fashioniser in 1993, she's an existing Funding Circle borrower, and as soon as she found out that she could get a loan through us, she very quickly applied. Really delighted with the speed. The turnaround time really allowed her to get back to running her business, in particular, producing more face masks actually, given the current environment.

Samir Desai: Or borrowers like Konk Furniture, produces handmade, sustainable furniture. Again, looking for support during the COVID period, found the whole process insanely easy, amazed at how quick the decision was. And getting a decision was very important for him because it allowed him to have the reassurance, but also allowed him to get on with the changes he needed to make in his business to help him thrive over this period. So by seamlessly collecting capital with small business borrowers that need access to it, in a super fast and efficient way, we really can stimulate economic growth and job creation.

Samir Desai: So in terms of our outlook, as I said before, we would not have wished for a recession and certainly not one as bad as COVID-19. However, we really do feel that we're proving the value of our platform and just how resilient it is, regardless of the economic environment. The economic environment does remain very uncertain and our H2 expectations are predicated on there being no further prolonged national lockdowns across our geographies, and includes the expectation of ongoing support for small businesses in the UK until the end of the year, but does not explicitly include additional government support in the US.

Samir Desai: We're reinstating our previous guidance of close to adjusted EBITDA breakeven in the second half, which we hope speaks to the confidence that we have in the business and its trajectory. And we really remain committed to delivering profitable growth and generating long-term value for shareholders.

Samir Desai: Thank you. We'll now move to Q&A.

Operator : We do have a question now, from Victor Cheng, from Bank of America. Please go ahead.

Victor Cheng: Hi, there. Thanks for taking the question. Two, if I may. First one on the EBITDA breakeven in H2. Just wondering what the drivers are? Is that primarily driven by less fair value adjustment that you obviously had in H1, so that's driving the EBITDA breakeven?

Victor Cheng: And then secondly, on the securitisation, how should we think about the investment EBITDA going forward? I would imagine fair value adjustment, like I said, will be less drastic in H2. So should we expect big improvement in H2? And how also we should think about the investment income going forward, as obviously now it's a bigger portion of your income. Should we expect further securitisation and warehousing to resume anytime soon? Thank you.

Oliver White: Okay, quite a few questions in there. So beginning to unpick those, so in terms of the EBITDA breakeven guidance, we would probably see income broadly similar, but perhaps a little bit more on the operating income or the fee income and a little bit less on the investment income. You're absolutely right, we would not expect the large fair value adjustment to be repeated, given it was driven by COVID-19. But there's always a small element of, if you like, BAU or non-exceptional fair value that we'd receive would continue.

Oliver White: But most importantly, as we spoke about in the presentation, we see a further reduction in our cost base, as we see the benefits realised from the announced restructurings in developing markets and in the US. I guess linked to that, to your investment EBITDA point, we still expect to see relatively significant investment income, but perhaps a little bit less as some of the vehicles pay down going into the second half. And clearly, we would not expect the repeat of the one-off fair value adjustments, primarily driven by the COVID-19 economic stress impact.

Oliver White: In terms of the future of securitisations, at the moment with the government programs, we're not actively doing a go-forward securitisation, in that our institutional investor funding and support for the government-backed SME

programs are done through other mechanisms. But we do see securitisations, or rather warehousing followed by securitisations, as being an efficient and effective way to manage our working capital. We do see in the future, we would expect the securitisation markets to normalise. We would be looking potentially to do more there, as and when our core products begin to get reintroduced. I'm not sure if Samir, you want to add anything to that?

Samir Desai: Yeah, I mean, the only thing I would add is the impact of COVID-19 has been unprecedented and the speed at which it impacted various markets is very different to previous recessions that we'd seen. The peak to trough in the fixed income markets was within the period of a few weeks. Markets were pretty much shut down for a period, whereas in say 2007/2008, it took a nine to 12 month period for that to really evolve and manifest itself. And as a result, we were unable to sell positions that we would have ordinarily expected in pretty much any other market environment to be able to do so.

Samir Desai: We'd continue to look to sell those positions as Oliver stated before, but the primary reason we introduced the products was to diversify the funding sources that we have on the platform and attract new investors onto the platform. We successfully added 30 new investors, so it is something we would like to continue in the future and would expect to continue in the future. I think this has just been a very unprecedented situation.

Samir Desai: And yeah, just circling back on the fair value point Oliver mentioned in the presentation, the fair value adjustment that we had in Q1 pre-COVID, was around 11 million. So that gives you a context of the ongoing type of levels that could potentially be expected without a very severe stress being applied.

Victor Cheng: Thank you. That's very clear one. Sorry, one follow-up, if I may, just on these vehicles where you said the expected future cashflow is 149 million. Over what time period are we talking about? What's the average duration of these vehicles?

Oliver White: It goes out potentially five to six years. It's really the average duration of the loan that drives that, and obviously the difference between the fair value and the future cashflows is driven by the discount rate.

Samir Desai: Just to be clear on these, our intention is still to sell these investments, and we were unable to do so in the timeframes. We would have preferred to do during COVID. But we put in the cashflows to illustrate that were we to decide to hold these to maturity, which I think is unlikely, we would, on a principle basis, not be having much impact on them. Just to show the long-term cashflows of the vehicles. But clearly, our intention is, like it's always been, to be selling these positions.

Victor Cheng: Yeah, that's clear. Thank you.

Operator: Thank you. Our next question today comes from James Hamilton from Numis. Please go ahead.

James Hamilton: Good morning, and thank you for your time. Just one for me. What I'd like to know, is what assumptions have you made on the other side, when we get to

recovery, in terms of potential collections from entrepreneurs who do recover, and any collateral values that there might be with regards to in the context of both your fair value adjustment, and of course, the estimates of returns from the cohorts that you have?

Jerome Le Luel: Hi, this is Jerome. So in our central stress scenario, we did assume a stress of the gross default, as per the orange curve that you can see on the graph. So we've assumed those multipliers by calendar months, going forward across all the cohorts and all the loans. And then on the top of that, we also assume a reduction in recoveries just to be prudent to the context of stress. So over the same period of time, we've assumed that for the loans who default, the percent of recovery would be 20% lower in relative term than it would have been otherwise. So in normal circumstances, we would expect around, on the more recent cohorts, we expect around 35% of recoveries. And we've reduced that by 20% to down to around 29, just to reflect the fact that there might be some stress on the value of the assets.

Jerome Le Luel: We've not assumed that these would bounce back in the short term. We've taken the conservative view that it would remain low over the period. There is a possibility that if the property market doesn't crash really, which is kind of where we are today, or if there is a bounce back of businesses, we might actually see more recoveries. But it's not something we've assumed in our central scenario.

James Hamilton: Thank you.

Operator : Thank you. I'll go to our next question now from Mohammed Moawalla from Goldman Sachs. Please go ahead.

Mohammed Moawal...: Great. Good morning, Samir, Oliver. I had a couple of questions. I guess, firstly, just given your originations showed re-acceleration in August and September, how much visibility do you have on the current government support for SMEs when the currently running schemes expire, particularly in the UK and US? And how many more schemes do you expect the government to launch for the remainder of this year and into 2021?

Mohammed Moawal...: And then just related to that, given the bulk of your originations now are dependent on some of these government schemes, should we anticipate any pressure on the take rate on some of these loans? Thank you.

Samir Desai: So thanks, I'll answer those. So with respect to the government schemes, the CBILS scheme that we participate in in the UK is an 80% guarantee scheme, and is actually a rebranding of an existing scheme called the EFG scheme, that existed prior to CBILS. What we've always said, is that small business lending is a much more resilient asset class than it appears when you first look at it because small businesses are strategically important to governments. They're 50% of jobs, 60% of private sector GDP. And so during recessions, there is always a mix of more government support, more guaranteed lending. This isn't just something we've seen in the UK and US. It's been in Germany, France, Spain, pretty much every developed country in the world.

Samir Desai: Now, COVID has been a very extreme stress scenario, where pretty much all the lending that we've done in the UK and US has been through these

schemes. However, the government has put in place some structural features of those schemes, which makes it very difficult to do non-guaranteed lending. So for instance, in the UK, the first year's interest and fees are paid by the UK government, which means that there's very little to negligible demand for non-guaranteed loans. However, we expect that structural feature to be withdrawn at some point. There's an announcement by Rishi Sunak today in the Commons about where the schemes will go and whether this particular feature will really be retained.

Samir Desai: But once that feature goes, we do feel that we can reintroduce our core lending product, and there is demand for that on the institutional investor side to purchase, given the performance that we've been able to show over this period, but also on loans originated during this period. But there will always be a mix of some of these guaranteed loans during recessionary periods because that's part of the nature of the model, we feel. It's either government's lend through platforms like us, or they provide guarantee schemes, which work.

Samir Desai: So really, we think that the reason why the vast majority of the lending has been done in this way, is really because of some very particular structural features, as opposed to necessarily us not being able to generate demand for non-guaranteed loans from the institutional investor side, but will be able to process that.

Samir Desai: In terms of the margins, as I said, we take a slightly lower take rate on the UK government scheme. The US government scheme is slightly different, in that it's a 100% guarantee scheme. So the margins of the loans we originated up until August 8th, were roughly half of our pre-COVID levels. However, there is uncertainty at the moment around whether there'll be an extension to the US government schemes. We haven't explicitly included it in our guidance just because of the US election. I think if there wasn't a US election, it's quite likely there's going to be some level of stimulus. It's just the period in which it enacts and whether it actually would happen for us in the second half.

Samir Desai: So overall, if there is an extension to the government schemes in the second half in the UK, which seems likely, there will be some pressure on the take rate, like you mentioned, but equally, volumes have been elevated. And then post this period, we do expect to continue to be doing some level of schemes and the schemes to revert to what they were before, but to reintroduce the core product and have the mix shift over time to much more non-guaranteed lending. But again, we do feel that this really demonstrates the resilience of small business lending, the fact it's a very different asset class too. You haven't seen guarantee schemes and consumer lending, credit cards, mortgages, things like that, and really speaks to the fact that we do believe our model is much more resilient than we've potentially been given credit for.

Mohammed Moawal...: Sure. I had one additional follow-up, if I may. Obviously, when you did the IPO, you were kind of no balance sheet risk, the business kind of evolved, and then you did some warehousing and securitisation. I think that you said that this will end. Is there any plan down the line once market stabilises and normalises, whether it's in 2022 or beyond to go back to any warehousing and securitisation business?

Samir Desai: Yeah. I think we added the investment products in 2019 to diversify the various funding sources on the platform, but also attracting a number of new investors. There are a lot of investors that cannot or do not want to purchase loans but are able to purchase bonds. And we saw a lot of successful adoption of the product last year. We added 30 new investors to the platform. Many of them pension funds, insurance companies, sovereign wealth funds, state municipalities, people that wouldn't have ordinarily purchased the loans. While we haven't said that the products would end, we do believe that they have enhanced our platform and certainly increase the visibility and understanding of what we do. And our plan would be, as we said, to sell off the various positions that we've got as we always intended to do so and to be able to warehouse loans and re-enter the securitisation markets at the appropriate time, because it does provide a diversification in the funding sources.

Samir Desai: I think we were unfortunately hit by the very unprecedented nature of COVID, whereby we had just started as a new issuer. We had a few of these horizontal positions that we were in the process of selling, that we were unable to sell due to the speed at which the crisis hit. Therefore, we have taken an adjustment on those positions. However, we had about £45 million of cash invested in those. The current valuation of those is about 10 million. They continue to generate income even as we hold them prior to sale. We don't think that this crisis has proven that these products aren't good. It's just that we unfortunately were hit with the timing of this and the very particular circumstances that we're in. But overall, as I said, it attracts a lot of new investors to the platform. It diversifies the funding sources and there is an income benefit, which in the second half of last year, it was around £10 million and is of benefit as well to the platform.

Mohammed Moawal...: That's great. Thank you very much, Samir.

Operator : Thank you. We'll go to our next question now, from Lucas Wojcik from Goldman Sachs. Please go ahead.

Lucas Wojcik: Hi, good morning. I just have one quick question. When we sort of think about the end of 2021 and the government schemes fading away, how do you think about bringing fresh capital back to the platform when the less risk but similar reward guaranteed loans by the government are gone and you need to ensure the smooth transition to potentially similar reward but a bit of a higher risk loans for investors.

Samir Desai: Yeah, that's fine. I'll take that one as well. I think the first point to know is that there are always government guarantee programs for small business loans. I'm sorry, my phone's just ringing. I'm just going to shut it off. There are always government guarantee schemes for small businesses and they exist across market conditions. There's the EFG scheme in the UK, which is basically what CBILS was a rebrand of. There's the SBA program in the US. There's KFW in Germany. There's BPI in France. All countries have these guarantee schemes. The reason why so much lending has gone through these is because of the very particular structural changes that the government's made to these schemes, whereby they were paying the first year's interest and fees, which mean that for small businesses, there's not much demand for non-guaranteed loans, basically. Because if the

government's going to pay the first year interest and fees for you, don't really need to go and get a normal loan.

Samir Desai: We have demand to purchase non-guaranteed loans and we saw that right the way through COVID, even in the months when we had significantly tightened the credit box. We still saw lending and purchasing of loans as we've shown on the slides before. What we expect is that we will be able to reintroduce the non-guaranteed products once the structural feature's removed. However, we would expect there to be a portion of our lending that will continue on government guarantees, and that would taper down over time as economies improve and we need to use them less. But I think, again, this is a very peculiar crisis as I'm sure you guys have seen in many other industries, both in terms of its unprecedented speed but also in terms of the impact where it's very rare to see a recession where businesses literally cannot open or are not allowed to open and trade. So we've had an extreme use of government guarantee programs. But in more normalised recessions, we would always expect that to be more guaranteed lending just at a much lower level than there was before.

Jerome Le Luel: If I could add something, two points. Firstly, through the COVID crisis, one of the benefits for Funding Circle is that we got accredited on these programs, when before we were not accredited. The governments in the US and the UK took a very conservative view on who should be on these programs and who shouldn't and typically, only traditional banks were invited. We did try in the past to join those programs but it was difficult given that we don't fit the banking box very directly. Now, given the urgency of fighting the pandemic, the government have relaxed their criteria to provide accreditation and went through bringing more companies in. And we benefited from that and now, we've proven that it works really well. We've been distributing those loans really well better than many banks and we think that this gives us a way to demonstrate that it should carry on and we should be part of it.

Jerome Le Luel: We have data we can show to demonstrate the performance of the loans we're originating. We have started to track this information and we're seeing the early signs is that the loans we're producing under those programs are looking quite good from what we can see so far. So we think we are building a credential here that is going to give us a different set of argument, going forward to participate with this in the long run.

Jerome Le Luel: The second point I want to make is that we're looking at our risk models and how they're doing through the cycle. And we are also pleased to see that our risk models are ranking risk. When we look at early delinquency on loans that were issued just before the crisis or on these guarantee loans, we can see that the risk models are doing their job. This is going to be a good way for us to prove to investors who want to invest into unsecured loans or non-guaranteed loans that we have the tools in place that are still performing to generate quality loans with good yields. We are currently doing simulations of those and we can see, we can deliver attractive yields to investors using our existing tools without a government guarantee if needed. So we're ready to restart when the market yearns for that, as Samir said.

Lucas Wojcik: Thank you.

Operator : Thank you. As we have no further questions on the telephone, I'd like to hand the conference over to David de Koning for questions over the webcast.

David de Koning: Thank you very much. Good morning, all. We have two questions here. First one is from Charles Elliott at Inflection Point Investments. Did you have any positive free cash generating months in the first half?

Oliver White: Charles, it's Oliver here. We had two months in fact, February and March. Now, it should be known that our cash has indeed ... Most businesses are, it's a little bit lumpy, so you can't read too much into a trend. But a summary, I did introduce January and February were very good months before the COVID crisis hit, and I think some of the strong origination performance in February helped that positive cash flow month. So in summary, we had two positive months.

David de Koning: The question from Miriam Adisa at Morgan Stanley, could you give more details on the different considerations you were taking into account when deciding on when to restart your core lending product in the US. Is the restructuring fully complete and what percentage of loans approved by instant decision technology would you expect by next year? And are there any cost savings from this technology? So maybe we'll take the US questions first to Samir.

Samir Desai: Yeah. I don't think I can remember all the questions. I hope you guys remember. On the US specific question, we are in the process of looking at re-introducing the core lending product. In the US, unfortunately, we're affected a little bit by the uncertainty over the government guarantee programs. As I spoke about in my presentation, PPP loans are 100% guaranteed loans that are forgivable, i.e., the borrower doesn't have to pay anything if certain conditions are met. So with the prospect of a PPP extension at the moment and additional funds that way, that does create some uncertainty amongst small businesses about whether they want to take additional debt, because clearly if they can get these loans from the government, they're a much more attractive proposition.

Samir Desai: So as we get more clarity on that, which will come quite soon, we'll ... Which really, again, is linked to the election, which makes it particularly difficult in the US because there are some political dynamics about whether that extension or a new loan scheme will come in pre the election or post, although both the Democrats and Republicans support it. Once we get some clarity one way or the other on that, we can start to ramp up the core lending product again.

David de Koning: Is the restructuring in the US fully complete?

Samir Desai: Yeah. The restructuring has been completed. I think from a cost perspective, we start to get the benefit from that from September. And the team has responded well. Some of the stuff are things we had considered, but were accelerated by the COVID crisis in terms of centralising our technology teams in the UK, and in terms of increasing our presence in Denver. However, the team have responded well. Within the US market, there has been an incredible dislocation of competitors, many being sold or having left the market, which is presenting quite a large opportunity for us as one of the survivors to really thrive and take a lot of market share.

- David de Koning: And then two separate questions on instant decision lending technology. What percentage of loans approved do you expect instant decision lending technology would account for next year? And are there any cost savings from this technology?
- Samir Desai: So in terms of what we've publicly stated so far, pre COVID, we talked about 50% of loans going through the instant decision lending platform by the end of the year. And we're clearly very much on track to deliver that. Really, the increase in the percentage will be driven by the maximum loan size that we actually put through the platform and that will be something that will prudently roll out over time. And also, once the bounce back loan scheme in the UK ends which covers the smaller loans below £50,000, which actually the technology is even more well-suited to but which we haven't necessarily been able to use it for.
- Samir Desai: In terms of cost savings, I think taking a step back from this technology, there are two primary benefits to it. The first is on the conversion side, which is if you're a small business applying for a loan, like anything we do in our lives, like ordering an Uber or ordering something or ordering some food or things like that, immediacy leads to higher conversion. So our ability to present an offer to a borrower instantaneously, once they've applied for a loan and almost get it into their bank account within a very short period of time, hoping to be minutes in due course, really changes the conversion levels of borrowers actually accepting loans because when they've got the offer in front of them, they're less likely to go elsewhere.
- Samir Desai: And on top of that, there are processing and cost benefits to us but it really depends on the volume versus cost trade off. We should be able to provide more details in due course, as the actual technology has taken more ... as we've used it for a longer period of time and what the actual savings or potential savings are. But really, it's not just about the cost savings, to be honest. It's really about the conversion. And then frankly, also all the new products that we can build on top of this, integrating into point of sale, integrating into other partners, producing completely new ways of small business borrowing that haven't even been thought of in the market yet. Really, those are the kind of big benefits I see on it beyond the pure the pure cost stuff. Look, I've been doing this for 10 years and I've been working to this moment for a long time. So for me, it really is the point of inflection in terms of what we can actually use the product for because no one else can do what we do.
- David de Koning: That's brilliant. The last of the questions. Thank you everyone for joining and have a good rest of the day. And if you have any follow up, please feel free to get in touch. Thank you.