

Funding Circle
Half Year Results 2023
Audio Webcast
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Transcript



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Lisa Jacobs :

Good morning and thank you for joining us for the Funding Circle half year 2023 results. The first half has been a good solid half for Funding Circle. We have delivered performance in line with expectations and demonstrated the resilience of the business and our aptitude at responding to the changing economic environment.

Our UK loans business is profitable, our loan returns remain robust and attractive for our investors, and we're making good progress on our strategic plan with growth in US loans and strong momentum in FlexiPay. We're continuing to do what we said we would in spite of the environment. I'm going to kick off with a quick business overview. I'll then pass it to Oliver for the financial results and we'll finish by running through our medium-term plan with a particular focus on FlexiPay.

We are the UK's leading SME finance platform with a material and growing presence in the US. To date, we've extended over £16 billion in credit from over 140 institutional investors to over 140,000 businesses. For our businesses, we offer a quick and slick way to get finance. Our instant decisions enable them to get back to doing what they do best: running their business, whether that's making Brazilian cheese bread, manufacturing furniture, or selling flowers.

Businesses come to us for finance for three things. To borrow, for the long term with our term loans in the UK and the US. To pay, spreading their bills and invoices over a longer term through FlexiPay. Or to spend, financing their day-to-day transactions with our FlexiPay card. For our investors, we offer access to an alternative asset class at scale with stable, attractive yields.

SME lending isn't easy. The market is underserved. As data is sparse, SMEs have limited assets and the ticket sizes are often small. We've solved this problem by using our proprietary technology and data. Our data lake has over two billion data points and we use this data to create models and in combination with our technology, this leads to valuable customer outcomes. Our models are three times better at discriminating risk than the Bureau scores. This leads to higher conversion for the same risk. Our customer experience is unrivalled. 75% of UK loan applicants now receive an instant decision. This is up from 70% in March. As a result, our customer satisfaction levels remain high with an NPS of 76 and a Trustpilot score of 4.6.

As I said at the start, this has been a good solid half for Funding Circle and I wanted to share some of the highlights. Despite the tough environment, our originations have grown 14% to £771 million. Our credit performance has remained stable, showing the strength of our risk models. We've priced up in line with the markets to continue to deliver attractive returns to investors, and as a result, we've agreed three new forward flow agreements.

I'm pleased with performance across each of our three business segments. The UK loans business delivered £1.4 million in PBT. It is our most established business and demonstrates the scalability of the platform even at a low point in the cycle. We continue to make controlled investments in the US loans business and FlexiPay in order to capture growth over the medium term. In the US, growth continued with more than 20% growth half on half. FlexiPay transactions doubled half on half. I'm encouraged by the customer engagement as we see strong recurring revenue trends.

Overall, whilst we remain mindful of the economic backdrop, the business has shown its resilience and adaptability. We're not standing still. We have a great team and in the first half we have, in particular, strengthened our US team with Steve Allocca, our US managing director who started in January and our US chief product officer who joined a couple of months ago. We have a clear strategy. We're optimising and finding new opportunities in our core business, launching new products and continuing to evolve the business.

Now over to Oliver for the financial performance.

Oliver White :

Thank you, Lisa. Good morning everyone. It is my pleasure to be able to share Funding Circle's financial performance for the six months to 30th June 2023.

We have shared this slide with you before, but I think it'll be helpful to recap on how Funding Circle makes money. We are a predominantly fee-based income model, what we call operating income, consisting of loan transaction fees and servicing fees, and increasingly also FlexiPay fees. Transaction fees are charged to borrowers and are driven by origination volume. Following testing and price elasticity, we've revised origination fees in both the UK and the US loans businesses. The typical yield is now circa 6% compared to circa 5% during the full year of 2022.

Servicing fees are more of an annuity stream charged to institutional investors at around 1% per annum and are driven by the loans under management.

FlexiPay's economic model is that of a fee charged to the transaction made against the line of credit payable in line with the FlexiPay loan over three months. A launch is to 3% with a rising base rate environment that is now 4.9%. FlexiPay income will account for an increasing proportion of fee income as the product scales. Investment income is driven by our capital invested in support of the loans businesses and, as expected, this has reduced.

Let's now look at the Group results. The financial performance in H1 2023 was in line with our expectations notwithstanding the volatile macroeconomic environment. Before we go into detail, it is worth

noting that we've made a number of changes to the presentation of our financial results in order to better reflect the changing nature of our business. We are now showing all interest earned within income. Previously interest earned on cash balances was shown below operating profit. This new presentation is clearer. It's consistent with peers and avoids a situation where, for example, a decision to deploy cash in one way leads to interest being recognised as top line income and deployed in another does not. This change also flows through into adjusted EBITDA. With FlexiPay becoming more material, we are now separately identifying the cost of funds at the expected credit loss line items. With no meaningful other items between operating profit and profit before tax, we no longer present an operating profit line item. Comparative financial information has been represented. A reconciliation can be found on the first page of the appendix.

Now, onto the results. Originations grew in each business unit, H1 23 compared to H2 22. Total originations are £771 million in the half, up 14%. This growth is despite our continued disciplined approach to originations and is testament to the strength of our business, even in tougher macroeconomic environments.

We continue to prioritise long term investor return performance over short-term originations. This is aligned with the expectations of our institutional investors and is a responsible approach to our borrowers.

Headline loans under management to continue to reduce to £3.5 billion as the government loan schemes continue to amortise down. Commercial lending loans under management continue to grow up to £1.5 billion, an increase of 9%. Total income was £76.6 million. We've grown from each of our business units compared to H2 2022. Income has grown despite the drag from the continued and anticipated reductions in investment income. As a reminder, H1 2022 still included the impact of a significant level of government loan schemes in the UK and some deferred revenue of the PPP scheme in the US.

Adjusted EBITDA was £3 million negative and PBT was a loss of £16.6 million. As we have previously guided, we anticipate losses near term as we choose to invest in growth, scaling our US loans and establishing our FlexiPay businesses. Our established UK loans businesses are profitable at the PBT level as we continue to deliver on effectively managing this business through the changing economic conditions. Cash and net assets remain strong. Funding Circle has cash of £204 million and a net asset value of £264 million. This puts us in a fully funded position to deliver on medium-term plans. I will now walk through each business unit in more detail.

The UK loans business is well positioned for continued growth. It is a market leading platform for SME lending, has scale, and is PBT profitable. Originations grew sequentially half-and-half despite the

impact with a continued distance approach to underwriting where changes have been made in September 2022. H1 2022 still contains a significant level of government guaranteed lending. Loans under management reduced as the government's supported lending book continues to amortise down. Commercial lending continues to increase.

Total income was £57.1 million, up from £56.5 million in H2 2022. This reflects the origination trends, the increase in origination fee yield, and higher interest income offset by the expected reductions in servicing income and investment income. Adjusted EBITDA was positive £8.8 million up from £5.7 million in H2 22. This was driven by income growth and cost management in the UK loans business driving improved margins and despite the reduction in investment adjusted EBITDA. UK loans adjusted EBITDA has been positive since half two of 2020, demonstrating the robustness and scale of the UK loans business. The business is profitable at £1.4 million profit before tax.

Turning to the US loans business, US loans continue to show good top line growth. US total originations increased 21% in half two to \$259 million. The US has continued to grow originations each half year since commercial lending resumed after the government supporting lending ceased in May of '21. As in the UK loans business, we are continuing with a disciplined approach to originations. Loans under management were \$502 million increasing from 454 in December '22. PPP loans are virtually all forgiven, only \$9 million remains in the lump.

Total income was \$20.7 million up from \$17.4 million. This improvement was driven by the increase in originations and loans under management and the increase in origination yield partially offset by the reduction in investment income. Underlying operating income continues to grow strongly. As a reminder, total income in half one 2022 included \$3.3 million of PPP deferred income, which accounting standards required to spread over the expected life of the loans. The US loans business recorded a negative adjusted EBITDA of \$4.8 million in the half and a loss before tax of 11.5 million. We are continuing to make controlled investments in the US driving scale to profitability.

Now to FlexiPay. FlexiPay's key drivers are transactions and end of balances, which are broadly comparable to the originations and loans under management metric of our loans businesses. FlexiPay transactions more than doubled to £90 million in the half. Period end balances have also grown to £34 million. This momentum had resulted in strong top line growth with total income of £2.3 million in H1 '23, more than double the prior half. EBITDA was £7.8 million negative as we continue to invest in FlexiPay. We have invested in technology and the FlexiPay team. Additionally, as anticipated,

marketing spend and the expected credit loss provision build both front run income. Profitability for FlexiPay comes from repeated usage of the product, which will become evident as the customer base becomes more established.

Operating expenses continue to be actively and tightly managed according to the strategic needs of each business segment. Funding Circle's cost base consists mostly of staff costs, marketing costs, and technology costs. Overall costs were £96.2 million in H1 versus £91 million in H2 2022. In summary, this is due to investment in the US loans business and FlexiPay, partially offset by tight cost management in the UK loans business.

The UK loans business is the most established segment with an increasingly efficient cost base that will allow us to benefit from operational leverage as we grow and as the economic backdoor recovers. UK loans in H1 23 demonstrated improved cost efficiency with costs decreasing to £56.1 million whilst total income increased by 1%. The US loans business is scaling up. Controlled spend in marketing and other costs have supported volume growth and platform scaling. Both H2 22 and H2 23 costs included roughly two million of impairment charges for the write-down of the sublet of the San Francisco office. FlexiPay is demonstrating a strong growth trajectory and as discussed, we are investing behind the product.

Let's now turn to our term loan performance and the returns provided to our platform investors. The overall book has remained very stable despite the macroeconomic environment. We have seen pockets of stress versus initial expectations in the 2022 cohort where we were forecasting small reductions in the expected returns in the UK of 40bps and in the US of 30bps. In H2 2022, we saw some leading indicators of stress in the macro environment and took pre-emptive action. The reduction in return expectations results from originations in the earlier part of that year, returns post tightening are aligned with expectations. All other annual cohort returns have either been revised upwards or have remained constant.

2023 illustrates how we've responded to the changing base rate environment, have been able to reprice into a steepening yield curve to maintain returns. These borrower price increases have been broadly in line with the wider market price moves. Clearly, we are dealing with a heightened period of macro uncertainty. We are confident with our credit strategy. We continue to monitor all indicators closely, are very agile, and respond quickly when needed. Our credit risk management is proven, our borrowers are resilient, and the loan quality is good. The loan returns demonstrate the robustness through the cycle of the asset class that Funding Circle has developed and also of the capabilities that Funding Circle has built to originate, underwrite, and manage these loans.

Funding Circle has a diverse, agile and sustainable funding model. The pie chart shows the diversification of sources of funding for our total loans under management with asset managers and banks continuing to be our largest investors. Within each of these segments, we maintain a further diversified investor base. The closed retail book continues to diminish as a proportion of our loans under management, now down to just 1%, and of the £3.5 billion of loans under management, only 2% is funded by Funding Circle capital invested.

We have continued to deliver sustainable funding and a flow of new loan investors. In the UK, as of the end of June, we have £1.6 billion of agreed funding, including signing an additional material forward flow agreement in January. In the US, we have £0.4 billion of agreed funding, including signing both a material asset manager forward flow agreement, and also our second credit union partner. In June, we successfully brought in Citibank as a senior debt provider to leverage Funding Circle equity invested in FlexiPay. This was through an initial £150 million facility. Executing this in demanding market conditions is again testament to the quality of Funding Circle's credit risk management and capital market capabilities. In the UK in August, we launched our participation in the third iteration of the recovery loan scheme and brought on Allica Bank as a new bank investor. This is another example of Funding Circle continuing to adapt to the changing macroeconomic environment.

Participation in the scheme enables us to meet our objectives of saying yes to more businesses and further diversifies our investor base. It's worth noting that the third iteration of the recovery loan scheme is quite different for some of the earlier programs, whereas during COVID government guaranteed lending displaced a large share of commercial lending. The most recent iteration of RLS is intended to work alongside commercial lending, addressing structural lending gaps. The majority of our originations will continue to be commercial lending. Our balance sheet remains robust. Net assets of £264 million, including cash of £204 million and invested capital was £69 million. The decrease in net assets of 20 million is driven principally by investment choices into US loans and FlexiPay. Cash has increased by net £26 million.

This is driven by, working capital movements including timing or payments to the British Business Bank, investment cash flow, including cash repayments from invested capital plus proceeds from the sale of the \$20 million of US loans were temporarily funded at the end of 2022. This was partially offset by the buyout of the remaining US securitisation vehicle as we continue to simplify our balance sheet. Growing the FlexiPay lines of credit and then leveraging with a new Citibank senior facility, these have been offset by trading results and our investments to support the growth in the US loans business and FlexiPay. Invested capital has decreased by £28 million,

converted to cash as described above. This slide illustrates how we think about using our cash and deploying our capital. I see our balance sheet as a source of competitive advantage. We support our operations.

We are in various stress tests and ensure we hold enough cash to protect against a combination of stress scenarios. We also fund the operating cash flows necessary for the US and for FlexiPay to scale to become cash generative. We invest where it makes the platform stronger, use cases include limited co-investment for risk alignment with our institutional investors, for example, as we do in the RLSs. And to support our research and development efforts before the associated products or features become adopted within our product set.

Funding Circle is the equity investor in FlexiPay. As already mentioned, towards the end of half one, we successfully leveraged that equity investment. We have sufficient cash to deliver on medium term plan, in addition, we have cash available for new growth opportunities should these become apparent. We will continue to manage shared dilution by supporting the employee benefit trust in purchasing our shares in the market to fulfil employee share awards.

All in all, I'm pleased with Funding Circle's financial performance in half one of 2023. We've achieved good results and volatile macroeconomic conditions with UK and US base rates looking like they will be higher for longer and the economic recovery pushed out. The business has proved to be resilient and adaptable. We have sustained our credit quality and loan returns. Institutional investors remain committed to funding an attractive asset class. Funding Circle has continued to deliver on its growth strategy, our solid performance and our robust balance sheet sets at the business well to drive future growth. We are well positioned for long-term success despite our expectation of continued economic uncertainty near term. Our 2023 and medium-term guidance is unchanged. I would now like to hand back to Lisa to take us through how we continue to execute on our strategy.

Lisa Jacobs :

Thanks Oliver. I shared our medium-term growth plan 18 months ago. As a reminder, we're in a strong position. We've built good scale in the UK loans business. The SME loans market across the US and UK is large and underserved. With more than £300 billion in loans outstanding. Our data and technology provides us with a sustainable competitive advantage and our customer satisfaction remains high. These give us good foundations from which to grow. We continue to make good progress against the three pillars of our growth plan. We are attracting more businesses through expanded and strengthened distribution channels alongside an expanded product set.

We are saying yes to more businesses, and this doesn't mean irresponsible lending, but rather expanding into segments and delivering the right product to the right business, whether our own or through our third-party lenders. And we're building products where we can achieve market leading positions with FlexiPay. I'll share some of the highlights on each pillar now. We are attracting more businesses through an expanded product set focused on brand investment and continued strengthening of existing channels. Each of our product expansions increases our relevance to our customers and enables us to go deeper in marketing channels. FlexiPay in particular meets a more frequent customer use case, attracting more customers. We've completed our first season of sports sponsorship to improve brand metrics with the Rugby Premiership in the UK. And we continue to strengthen our existing channels with new partnerships such as Sage in the UK.

I've spoken before about lending as a service in the US, a more embedded partnership where we partner with financial institutions to enable their SME lending. We knew that these partnerships would take some time to come to fruition and the Silicon Valley Bank failure and knock-on effects have delayed this further. As a result, whilst we remain excited about this opportunity, I do not expect to see any material contribution from lending as a service this year. We want to say yes to as many businesses as possible by expanding our end-to-end conversion. Last month in the UK, we began our participation in the government's third iteration of the recovery loan scheme. We'll offer these loans alongside our commercial loans, and it enables us to serve an incremental number of businesses.

Last year, we leveraged our data to find further opportunities and expanded into super-prime in the US and near prime in the UK. In the US in the first half, super-prime was nearly a third of originations by value, helping fuel our growth. In the UK near prime was 12% of volumes of origination. The value is smaller, about 7%. However, the number of loans is important as these loans typically are to newer or smaller businesses, and we expect to see migration from near prime into our prime product over time. We've strengthened our marketplace referring businesses that we cannot support to other lenders and enabling us to leverage and monetise our advantage in distribution and marketing. We work with 30 lenders and in the UK we can now make third party offers via our API in as little as 15 minutes. Our marketplace now accounts for 13% of our group originations.

Our third pillar relates to new products. As a reminder, FlexiPay solves SMEs biggest pain points, cash flow management. It enables us to solve more of our customer's needs, building a deeper and more engaging relationship and access a sizable new market. We are seeing good growth with the doubling of transactions in the first half. Our total transactions are now more than £150 million, and after a

successful beta phase, we're moving into the launch phase for our FlexiPay card, enabling customers to finance their day-to-day spend. In line with the product having reached sufficient maturity in scale, we're excited to have senior debt funding from Citibank in place, which helps accelerate FlexiPay growth and diversify our funding sources. To bring FlexiPay to life, I'm going to play a short video to show you how it works and how our customers are using it.

[Video plays]

Lisa Jacobs :

That video gives just a little window into the positive feedback and engagement that we're seeing from our customers using FlexiPay and a FlexiPay card. FlexiPay transactions more than doubled in H1 23 to £90 million and we have over 3,800 active lines of credit. We have high customer engagements with businesses using FlexiPay, 1.3 times on average each month. Businesses of Flexi paid more than 40,000 times since we launched. What is particularly exciting for me is the charts on the right-hand side. This shows transactions each half by cohorts of joining FlexiPay shown in the different shades of purple. You can see the overall growth, the doubling in the most recent half and the new customers that we're bringing on over time. But also the level of engagement we see with existing customers. Once a customer begins to use FlexiPay, they continue to do so and it becomes part of their day-to-day way of managing the business. As you look at this cohort analysis, you can see that trend with strong and increasingly predictable repeat usage, delivering recurring revenue.

The product economics and risk profile are attractive. We take the marketing costs upfront as we acquire customers, but the credit cycles quickly and the nature of the customer relationship is long. Customers come back and the product has frequent usage and recurring fee income. This is why we continue to be really excited about the opportunity that FlexiPay will generate and why as Oliver explained, we're investing in FlexiPay. In summary, despite the tough economic environment, we've delivered a good solid set of results in line with expectations. We've once again demonstrated the resilience of the business and our aptitude at responding to the changing economic environment. Our UK loans business is profitable. We have seen good growth in the US loans, business and FlexiPay. We are continuing to execute on our medium-term plan to address the large and underserved market in both the US and the UK.

Our technology and data give us a clear competitive advantage and is the moat around our business. It delivers a superior customer experience through our instant decision lending technology, a platform on which to build new products and three times better risk discrimination than the Bureau scores. We have delivered robust and attractive loan returns thanks to our risk approach, which combines our data and analytics with a credit expertise overlay and means we

continue to see strong investor demand. Looking ahead, we have a strong team, a clear strategy, and we're focused on executing against our plan. We are unwavering in our mission to help more small businesses win, and we continue to do so in spite of the volatile macro environments. Thank you for joining us today, Oliver and I would now be very happy to take any questions.

Operator : If you would like to ask a question, please press star one on your telephone keypad. Please ensure your line is unmuted locally as you'll be advised when to ask your question. So once again, that's star one if you would like to ask a question. And the first question comes from the line of Kim Bergoe from Numis. Please go ahead.

Kim Bergoe : Morning, Kim Bergoe from Numis. I have three questions if I may. My first question is, think of your results here, more of a sort of proof of concept than performance in the first half. I'm thinking about the profitability of your business and how I should be thinking about that. Could you expand a little bit on that? Is UK as your more mature business and obviously the largest part of the group, the profitability there that you've shown in the first half, is that a good indicator of where the business might go? And if you can expand a little bit on that by division.

My second question is how we should be thinking about the funding side. I mean the current trends. How is the funding side, for instance, are they reactive to a higher interest rate environment? Are you still competitive and seen as the same provider as you were in a low interest rate environment? And my third question is around credit quality in terms of what's the outlook and current trends, and if you obviously split that by UK, US term loans and then FlexiPay. And then how you are responding to changes in that environment. Thank you.

Oliver White : Hi, Kim. Some good questions to get us started. So first on profitability, I think you're right in that we need to think about profitability based on the separate dynamics of the three business segments. So yes, the UK Loans is the established part of the group. It's PBT profitable in the first half of the year and we'd expect that to continue. It's been AEBITDA profitable since half two of 2020. As I think we've also demonstrated, we see good operational leverage. So, as we continue to grow as the economic backdrop improves, we would expect to see good operational leverage come through and continued profit growth in that segment.

In both the US and in FlexiPay, we're continuing to invest, so investing in the US to bring it to scale. And we will continue to see similar investment in half two, maybe slightly more in the US as it scales up. And in FlexiPay, again, a pattern we're investing in the technology and the team, but also, some costs – marketing and the expected credit loss provision build front-running income. FlexiPay has very much got a model of lifetime value and repeat usage. So,

some costs are incurred upfront and the revenue comes over an extended period. In terms of half two, we've guided on income for FlexiPay and AEBITDA, costs again will be equal to or maybe slightly greater in half two than in half one.

Your second question, I think, was on funding. We continue to see strong demand from funding partners to work with Funding Circle and work on our platform. We have high levels of agreed funding in both the UK Loans and the US Loans businesses. And during the half, added one new funding partner in the UK, two new funding partners in the US. Also, as mentioned, we leveraged the Funding Circle balance sheet investment in FlexiPay, bringing on Citibank as a senior debt provider. And that was a major achievement given the newness of the product, the challenging economic environment, which again is testament to both our risk management skills, the attractiveness of FlexiPay as a product and our capital market skills. We've also further diversified our product mix. And with that our funding mix, participating in the third iteration of the UK government's recovery loan scheme and bringing on Allica Bank as a bank partner to fund that.

Your third question was around credit risk and credit risk trends. We continue to see a very stable book, and that manifests itself into the attractive returns we continue to offer our institutional investors. End of 2022 and '23, which you can see on slide 13 of the presentation, we've successfully priced into the rising yield curve. We've met borrower expectations of higher nominal returns. That's reflected in higher borrower price points, but we've priced very much in line with the market. And linking back to the second question, we are still seeing strong demand from institutional investors, and that's because the returns and the credit risk performance remains very, very strong on Funding Circle loans. Hopefully, that's covered your various and quite broad questions.

Kim Bergoe : It has indeed. Great, thanks. Just one follow-up if I can. Can you just remind me how to... The duration on your funding side, I know it doesn't quite work like that, but how should I be thinking about that? The general, how when you make and when you have a new funding provider in there? I take it, basically, if there is a duration on your funding side, it's actually longer than the duration on your loans. Is that the correct way of thinking about it?

Oliver White : I think there's probably two things there. So, our institutional investors buy loans. In other words, a loan is sold to those and they fund that loan for the duration of that loan. In terms of our funding agreements, these are typically multi-year. They vary by agreement to agreement. But for example, the amounts quoted on the funding slide carry over into 2024.

Kim Bergoe : Okay, great. Thank you very much.

Operator : The next question comes from the line of Rahim Karim from Investec. Please go ahead.

Rahim Karim : Good morning. Thanks for the chance to ask some questions. Three, if I may. You talked about the yield increases that you'd managed to achieve. Especially on the transaction side, just to try and get a sense of how all those have been received by clients, I guess it's slightly easier given the movements in interest rates to pass through a slightly larger transaction fee because it's obviously a smaller proportion of the total amount that someone's paying. But just any colour you could provide on that and how sticky you think that fee increase is and whether, in fact, there are any further opportunities like that within the business.

The second question was just around RLS. Clearly, it looks like an interesting complementary opportunity. If you could perhaps give us a sense of how significant you think this could be and within the mix of the business and the portfolio. And then finally, on the UK business, it'd just be useful to get some colour, if you can, in terms of the strong cost performance there. I assume that's headcount driven. Be useful just to confirm that and also, get a sense of how you see that cost income ratio potentially evolving going forward and the operational leverage that should come through. I guess a little bit to Kim's point earlier around how the profitability of especially the UK business should evolve over the next year or two.

Lisa Jacobs : Hi, Rahim. Thanks for the questions. Good to hear from you. So, on the first one, I'll take the first two, and then I'll pass to Oliver for the third one on the UK costs. In terms of the yield increases on the transaction side, you're right. We actually find whenever we do any of these changes, we do test them first and we check price sensitivity to our borrowers. So, actually, we've been able to pass these through quite easily in the context of, I think everything is becoming more expensive and so, costs are being passed through throughout.

In terms of further opportunities, we're not planning any further raises at this stage. So, I think those will be stable going forward. RLS, you asked about RLS. We see this actually as a really nice, natural extension to the commercial loans that we're doing. It enables us to serve an incremental set of businesses that we wouldn't have been able to serve otherwise. But it's worth noting, this is a very different programme to those programmes that existed through COVID, like CBILS and Bounce Back Loans, and this is intended to be incremental. So, we still see the vast majority of our loans being commercial loans, and the scheme is due to end in June. And I'll pass to Oliver for the last question on UK costs.

Oliver White : So, on UK costs, as you've noted, we expanded the margin in the UK with income increasing and costs reducing. The UK is a scalable established platform, and we will continue to manage costs tightly. I

would expect costs in half two to be broadly flat as opposed to continually reduced. Though clearly, we expect income to continue to grow in half two.

Rahim Karim : Great. Thank you both so much.

Operator : Next question comes from the line of Perlie Mong from KBW. Please go ahead.

Perlie Mong : Hello. I guess just two questions. One is going back to the credit quality, especially in relation to FlexiPay. I guess the reason I'm asking is, because obviously, now you're taking an impairment charge for the FlexiPay product, and because obviously, that book is growing very fast. And typically, for other banks, as they grow very fast, you'll have to take more Stage 1 model impairment charges. And obviously, as book seasons, you'll also see some of it moving into Stage 2. So, almost mechanically just by growing the books and having it around for longer, you should see that line grow.

Is that the same for you? So, I guess that's the first part of it. And the second part of it is, your credit experience so far, how does that compare to your main loan book? So, just your experience so far with FlexiPay, is there any difference in trends, for example? So, I guess that's the first question.

And the second question is relating to your medium-term target. So, I guess if I look at especially the income part of the target, if I look at half-and-half growth in the first half of this year, it's about a 12% increase in operating income. So, just on that run rate, it would be pretty close to the medium-term target in 18 months' time. But I would expect loans under management to either be flat or maybe down a little bit as more of the government loan schemes roll off. So, I guess that would affect the service fee part.

And origination has been good so far, but obviously, the macro trend for the sector is quite challenging and SME loans have been falling for a lot. And I guess especially with some of the larger peers have obviously talked about SME loans being quite anaemic in general. So, if origination were to, I don't know, flatline or come down a little bit or have a more difficult trend, then obviously, I know you're growing FlexiPay, but it is still as it is quite a small part of your income, so just any other levers or factors that would help you meet the medium-term target would be helpful. Thank you.

Oliver White : Okay. Hi, Perlie. Thanks a lot. Quite a lot in there. I'll try to unpick it, but let me know if I miss anything. So, I'll begin with FlexiPay and the expected credit loss provision. So, you're absolutely right. We do an IFRS 9 provision similar to banks and other non-bank lenders. It front-runs the income, which is part of the investment J-curve we go through on FlexiPay. It will grow as we ramp up FlexiPay. You're

absolutely right there. It's included as part of our overall FlexiPay guidance. So, when I spoke earlier about costs increasing slightly in half two, that includes the element of costs that are the ECL provision, and I think you can look at our RNS and see that it was about two million in the half.

Clearly, FlexiPay is new. We haven't got a lot of observable data. Very happy to say a lot of that observable data we're lacking is defaults or delinquencies because the books perform very well. But we think, if anything, we've been relatively conservative in our approach to ECL on a new product, but fundamentally, you're right. That will grow as FlexiPay continues to scale up quite rapidly, but that is contained within the guidance we've given on FlexiPay. Our overall risk performance on FlexiPay is very much in line with expectations. Again, with a caveat, it's a new product. We haven't seen any material deviation in trends between FlexiPay and between the term loan book in the UK. It's not that one's performing well and one's not performing well. We've seen a very similar pattern of performance.

Moving on to guidance, we reaffirmed our medium-term guidance. Clearly, we are sensitive to the broader macroeconomic environment. I think we all expect by 2025 to have more certainty and some degree of a more attractive economic environment. But I think what you've seen is Funding Circle continues to adapt, continues to be resilient, and continues to manage the P&L well. I think our participation in the third iteration of the Recovery Loan Scheme is testament to seeing an opportunity to serve our customers whilst managing our P&L.

To your point, specifically on servicing income, so in the US, we're growing loans under management. In the UK, you're right; loans under management reduced half-on-half and that was due to the high level of particularly CBILS, origination, amortising down and washing through. Commercial loans under management grew. I would expect UK loans under management to continue to fall in half two of this year and turn around as it were during 2024. So, growing again comfortably by 2025.

Equally, you're right; we have a number of income streams, transaction fees. And as you saw again, we've worked on the yield part. Plus, originations are growing. Interest income, servicing fee income and a little bit of residual investment income, so some diversification of income streams. All in all, that gives us the confidence to reaffirm the medium-term guidance.

Perlie Mong : Okay, thank you.

Operator : I will now hand over to Morten Singleton, Director of Investor Relations, to relay some webcast questions.

Morten Singleton : Hello, everybody. Yes, we've got a few questions online. So, I'll relay perhaps the first three of those before handing back to the operator for the caller questions. The first one comes from Vish Bhatia of J O Hambro. It's a question for Oliver. On the FlexiPay funding from Citibank, please, can you provide colour around the process? How long did it take? How competitive was it? And what level of annual transactions can this £150 million line support in addition to your own equity? Would the team still be interested in adding more debt providers to further support FlexiPay growth?

Oliver White : Okay, thank you. It was a competitive process. We had interest from a number of banks and Citibank won out. We have a strong existing relationship with Citi, which again is a testament to the capital market capabilities Funding Circle developed over the years. The process was completed in line with our target timing. It was completed at terms that I'm happy with. For commercial reasons, I'm not going to be able to reveal the pricing or the advance rate, but certainly, I'm quite comfortable with where we got to.

The amount supports the longer-term growth of FlexiPay. And we entered into an arrangement of an initial facility with an opportunity if need be to upsize it in order to support our existing plans. We do not need to upsize during 2023. It carries us quite comfortably into 2024. Because of that and because we have a good relationship with our counterparty, at the moment, we're not looking to bring on a second partner.

Morten Singleton : Thanks, Oliver. The next question is for Lisa, also from Vish. You mentioned the group has in excess of two billion data points. How are you using the capabilities of AI and machine learning to improve your own decision-making process, scalability of your proposition, and maybe even coming up with new product innovations? Thanks.

Lisa Jacobs : Hi, Vish. Thanks for the question. So, let me talk a little bit about how we're using AI machine learning today and how we have been, and then also gen AI going forward, given that's what's on everyone's mind. So, today, in our modelling, we're using... Machine learning AI helps us to get the best models, and we continue to drive benefit from that, and that's why we have the better risk discrimination that we see with our models versus the bureau score three times better at discriminating risk. This also enables us, you spoke about new product innovations, it also enables us to find opportunities given that large dataset. So I mentioned in the presentation, last year when we launched Super Prime in the US and we launched Near Prime in the UK. That was because we could identify a pocket of businesses for whom we could either serve much better prices or that we could serve who were newer, less established, smaller businesses. So that's been a very tangible example of where we've been able to use our superior modelling capability. Going forward, when we think

about gen AI, there's obviously lots of hype around this, and we see it as an exciting new technology.

We see the use cases being mainly in three areas. So the first is productivity, and we're doing some trials around that, in particular in our software engineering, looking at how we can use tools to make them more productive. Writing code, being able to manage knowledge management through the team. We're also looking at it from secondly, customer experience. So can we use AI to drive better, more targeted communications? Can we use that in some of the ways that we interact with our customers? And we're doing some trials there. And then there's this third bucket, which is more transformative. So we've got a few test ideas there that we're working through in a cross-functional team across the business.

Morten Singleton : Thank you, Lisa. And the last question for now from the webcast comes from Matt Evans of Equity Development. This question is for Oliver. How do you look at competing priorities in terms of your capital allocation while also keeping a disciplined approach? If you had an extra pound to spend today, would you most like to deploy it via more lending, and if so, would that be in UK Loans, US Loans, or FlexiPay, or in other areas like developing new products or increasing the marketing budget?

Oliver White : So, we are fully funded for our existing medium-term plan. So Lisa spoke about it both today plus at the last full year, our medium-term plan and our various objectives around that. So the first use of that cash is to deploy to deliver what we said we'd do and which we're making great progress on delivering. And we will continue to be very efficient in our cash usage there. And the leveraging of our balance sheet investment in FlexiPay is an example of that, as is some of the monetisation of the legacy loans investments recycling into cash. So we continue to look to maintain a very efficient use of our cash and of our capital. We also, as I mentioned, retain some cash as a prudential buffer, which in today's volatile macroeconomic environment is a very sensible thing to do. And we also use some cash, a very small amount, to avoid or to manage share dilution by supporting the employee benefit trust in buying any share awards. Over and above that, we have some additional cash that we would deploy into future growth opportunities as and when they become apparent. Morten, back to you.

Morten Singleton : Yeah, back to the operator for taking calls from the line.

Operator : Thank you. For the next question, it comes from the line of Alexander Bowers from Berenberg. Please go ahead.

Alexander Bowers : Just three questions for me. Firstly, on funding, the funding agreements you signed in H1, just confirm whether those are all with new investors or whether some are sort of repeat investors. Would

also love to get a view as to what the pipeline looks like for funding going forward. Secondly, on lending as a service, I was wondering if you could give us some feedback on how your existing partnerships and pilots with Pitney Bowes and DreamSpring are progressing, what you've learned from those to date. And then, lastly, on cost, you grew headcount in FlexiPay, just wanted to get a view as to how many more people are required to bring that business to scale. Thanks.

Oliver White :

Okay. Maybe I'll do the first and the third, and Lisa could speak to LaaS. So in terms of funding, all the three agreements we spoke about, one in the UK and two in the US, were with new investors. Though, it's worth noting that the US is an existing investor in the UK. So it's building a global relationship, which, again, I think is a powerful testament to the attractiveness of the asset class, the credibility which Funding Circle's seen, and the ability to develop strong and deep capital market relationships. In terms of pipeline, we always look to have an active pipeline. We always look to have diversification, but equally, we're conscious that our institutional investors look for a degree of scale. So it's a slight balancing act of keeping diversification, keeping the potential for new pipeline, yet meeting the existing expectations of our existing investors. So we have an active pipeline. I'm not necessarily expecting a lot, new news in the very short term because we're quite happy with our funding position. Lisa, any thoughts on LaaS? And I'll pick up the third question.

Lisa Jacobs :

Sure. So on Lending as a Service, just as a reminder, this is where we have more integrated partnership with financial services institutions, that enable us to serve their customers with small business loans, and the partner themselves provides the funding. And the reason that partners look to us is because of the expertise that we have in underwriting, the technology, the process, that straight-through proposition that we can provide. We remain really excited about this opportunity. You can see that we're pretty uniquely placed in the US to be able to offer this to partners and Steve and the team. Steve is building the team to be able to enter into that market more so.

As I said in the presentation, it has been slightly delayed given Silicon Valley Bank and the community banks, the implication thereof, and those were a number of our partner targets. In terms of the existing relationships that we have, we've learnt around who are the right partners for us to partner with and where this proposition will work most effectively. And that's in terms of things like the size of their SMB base, the type of relationship that they have with those customers, and the type of proposition that works, as well as which types of integrations work most effectively. And those are learnings that we're feeding into our go-forward approach with Lending as a Service.

Oliver White : Okay. And the third question, I think, was around FlexiPay costs and particularly FlexiPay headcount. So we have, as you said, ramped up FlexiPay headcount both in terms of the technology teams, the product teams, the commercial team, and some of the sales teams. In particular, we've learnt sales and outbound sales is quite an effective route to spend our marketing money on with FlexiPay. I would expect to see further modest growth in FlexiPay as we continue to ramp up the product and build out the capabilities. Thank you.

Alexander Bowers : Thanks very much.

Operator : Next question comes from the line of Orson Rout from Barclays. Please go ahead.

Orson Rout : Hi, thanks for taking my questions. Just two quick ones from me. The first is on 2023 guidance, which, of course, is unchanged on a headline basis. But if we account for the new presentation of interest income and look at it on a like-for-like basis, it's of course a slight downgrade, especially on AEBITDA, where the interest on cash will of course flow through. So I was just wondering, given this accounting change, do you now feel more confident that you'll be able to deliver the top end of the guidance, or has the macro toughened more than you have expected, which would not give you the confidence at this moment to guide more towards the top end of the guidance? So that's the first one.

Then the second question was just on FlexiPay, where obviously to achieve the 10 million target to '23, you need quite a sequential optic into H2. So I was just wondering if you could give a little bit of colour on what gives you the confidence to achieve such a ramp up. And maybe you could touch a bit on the cohort analysis because, looking there, I can see that, for example, the 1H '22 cohort doesn't seem to have grown too much from the 2H '22 levels, but more recent cohorts are performing quite well. So I was wondering if you've been making any tweaks to the product that have seen more net customer retention within FlexiPay as well. Thank you.

Oliver White : Okay, thank you. I think first of all, around guidance. So yeah, we are confident in our '23 guidance, and reconfirmed that. It's fair to say we are seeing a more challenging macro environment than when we published the guidance back at full year. But I think as half one proved Funding Circle is showing agility and adaptability in running the business through these challenging times. I think your point about interest income is probably the wrong way to look at this. So when we set the guidance, interest income was not significant. We've effectively done the re-presentation in order to provide clarity, in order to be comparable with peers, and most importantly, in my view, to avoid the situation of how we chose to use our cash resources resulted in interest income appearing in different places on the P&L.

In terms of your FlexiPay question, you are right. We have a significant ramp-up in half two. That's driven by three main things. The first is, as mentioned, the FlexiPay fee charged has moved from 3% at launch to about 4.9% now. That change happened at the end of half one, beginning of half two. So we have the full benefit of that yield improvement flowing into half two. The second driver is new customers. So as slide 24 in the presentation shows we continue to add new customers coming into FlexiPay, and we expect that trajectory to grow. But the third dynamic, which is illustrated brilliantly by the chart in slide 24, is as we bring on customers, they then use the product more. So customers who joined FlexiPay in half one, particularly towards the end of half one, their usage would itself ramp up. And those three factors together give us confidence that we would deliver the income ramp-up we are projecting in half two. I think you had another question also, which I have to admit slipped my mind. Could you remind me?

Orson Rout : No, I think that answers the main two. I guess the follow on was just a bit on the cohort analysis for FlexiPay and whether you've changed the product over the last couple of half years to increase stickiness and net retention. But I think the first two answers already give a lot of colour on FlexiPay, so that's helpful.

Lisa Jacobs : Yeah, and Orson I can pick up on that latter one. I think what you see in the cohort analysis and what we expect going forward, the level of interaction is somewhat limited by the level of credit line that we give to these customers. So we wouldn't expect each cohort to grow exponentially as they come on board, but rather for those to be flat with a small amount of growth from level of engagement. And then, over time, as those businesses become more established, maybe we're able to increase the credit line.

What we are doing, though, in terms of product features, which I spoke about, we've completed our beta test on the card, and we've moved into launch phase on that. And what that means is, in addition to the FlexiPay line of credit, where we have customers spreading their invoices over three months, we capture a larger share of customers' spend payments because we capture that through their spend throughout the course of the month. So typically, at the moment, on FlexiPay, the average transaction size is about £3,000-£3,500. Whereas what we are finding through the beta is that customers are using the card much more frequently and therefore building up across various smaller spends throughout the month.

Orson Rout : Okay, super helpful. Thank you.

Morten Singleton : Thanks, Orson. I'll just pipe in. We've got one last question from the webcast from Vish Bhatia, J O Hambro, it's for Oliver. On the significant cash pile, the group has in excess of 170 million

unrestricted. What kind of rates is the business able to deploy these funds at?

Oliver White : We are very actively managing these rates. We've moved a lot of the money into money market accounts. It varies by account, and it varies by geography, but we're receiving three to four plus percent.

Morten Singleton : Thanks, Oliver. With that, I think we're able to close. Thanks everyone for your attention today.

Oliver White : Thank you.

Lisa Jacobs : Thanks very much.

ENDS