26 November 2019

Prospa Group Limited 2019 AGM

Chairman's Speech

Gail Pemberton AO
Prospa Chair

Before I begin my comments on the 2019 financial year performance, I would first like to address our trading update announced last week. We owe shareholders an apology. While we believe we have the right strategy to drive the best long-term value for shareholders, the Board is disappointed in the performance of management in the first half. We are committed to working with them to restore market confidence.

We acknowledge the update raised several questions from shareholders, and therefore we have asked Greg and Beau to spend some time today discussing the answers to these questions.

Financial Performance

The 2019 financial year was a busy year for Prospa. We successfully launched into New Zealand, brought two new products to market and on 11 June we listed on the ASX via an Initial Public Offering of ordinary shares in Prospa Group Limited.

The offer raised $60 million in primary capital and was conducted to support our growth strategies, working capital; repay our corporate debt facility and provide access to capital markets for future growth.

Financially, the year was characterised by continued momentum and strong demand, with originated loan volume of $501.7 million, up 36.6% on the prior year.

Revenue of $136.4 million was up 31.2% on the prior year.

We also delivered pro forma Earnings Before Interest, Tax, Depreciation and Amortisation of $6.8 million for the 2019 financial year.

We now have a balance sheet that is well primed for growth. We have nearly $70 million of cash on the balance sheet to fund investment in the small business loan product in addition to the new initiatives in New Zealand, Line of Credit and ProspaPay.

Culture and Governance

From the outset, we recognised people would power our success and we have invested in building a diverse and inclusive team and a culture focused firmly on our core values. The executive team has broad expertise spanning financial services, technology, sales and marketing, compliance and distribution and together they lead a passionate team of almost 250 small business advocates.

Prospa's Board comprises six Directors including three independent non-executive Directors, one non-independent non-executive Director, as well as our joint Chief Executive Officers. The Board has created a governance framework designed to promote responsible management and conduct.

Following the guidance update last week, your Board has also asked to see:

- improved processes, controls and change management; and
- additional resourcing with a focus on modelling, forecasting and expense management.

Your Board will regularly review management's progress in making this capability uplift, and we expect substantial uplift by the end of the third quarter of FY20.

In January 2019, Prospa was pleased to announce that it was one of the first online lenders to be operating in compliance with the AFIA Online Small Business Lenders' Code of Lending Practice. Prospa has been instrumental in developing the new Code and reaffirms its commitment to increased transparency for small business customers.

Outlook

With the 2020 financial year underway, the Board and management are fully committed to delivering our revised outlook.

We now expect total originations for the 2020 financial year to be in the range of $626 million to $640 million, an increase of between 25 and 28% on FY19. And we anticipate revenue will be at least $150 million. I have asked Greg and Beau to comment further on this in their address.

Prospa is a strong, fast growing business with a continued commitment to putting our small business customers first. We are motivated to achieve our growth strategies for the year ahead; expanding our reach to more of the small business economy; growing our business in New Zealand; and continuing to deliver solutions for small business customers through our new products.

I would like to thank our customers, partners and funders for their continued support and for sharing our vision.

I would also like to thank my fellow Directors Fiona Trafford-Walker, Greg Ruddock, Avi Eyal, Greg Moshal and Beau Bertoli for their contribution and collaboration.

Most importantly, thank you to our shareholders who have supported Prospa on its journey so far.

We acknowledge you expect more of us and we will work hard to meet your expectations. We look forward to keeping you updated on our progress in the year ahead.

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Joint CEO's Presentation

Greg Moshal and Beau Bertoli, Prospa Joint Chief Executive Officers

Last week we provided a trading update to the market with revised forecasts. We're fortunate to have shareholders who have supported and believed in us and we understand your disappointment. We are deeply sorry for the results not being in-line with our forecast and are taking all the necessary steps to build a stronger business for our shareholders.

Before we discuss the 2019 financial year, we're going to take a moment to make sure we have fully addressed the questions arising from our trading update last week.

We announced last week that we were pleased that our originations have continued to grow strongly after we closed off FY19 – in fact, originations were up 40% in the four months to 31 October 2019 when compared to the same period last year.

In the same period, we've also grown total customer numbers to 24,000. We continue to see strong take-up of Prospa's small business loan, but also strong appetite for our new line of credit product.

However, we reported that what we're seeing in originations is not the same as what we're recognising in revenue.

The main reason for this is the premiumisation of our portfolio.

We will now explain what we mean by "premiumisation".

Our strategy involves attracting better credit quality customers. These premium risk grade customers have three main benefits:

- We see this revenue as less risky as the probability of default is usually significantly lower, with our impairments experience currently well under 4%.
- Lower impairments can lead to improved funding costs and funding diversity, as seen with our two new banking facilities.
- In the long-term, we believe these customer segments should have higher lifetime value, as they typically trade for longer, are larger businesses and are more likely to take up recurring revenue products like our new line of credit.

We see this strategy as helping us build a larger scale, more sustainable business, capable of capturing more of the $20 billion market opportunity.

We've also had some additional questions from the trading update that we'd like to address now.

We've been asked why our revenue is so sensitive to the introduction of new lower rates.

Our revenue is sensitive to a lower rate card distribution because our loan product is shorter in term and we charge a fixed interest rate. This means small movements in rate or term can generate a greater impact than in longer term or variable rate products.

In addition, there is a large price range between the lowest credit quality customers - who receive a 26.5% per annum simple interest rate - and our highest credit quality customers - who receive 9.9% in our rate-for-risk model, so revenue is also sensitive to the overall risk grade distribution of our small business customers.

We've also been asked why we chose to introduce the new rate card during the prospectus forecast period.

Prior to the introduction of the new rate card, we received new funding from a major Australian bank that would reduce our funding costs. Our strategy has always been to continue to reduce our funding and unit costs and pass these benefits on to our customers as lower rates - in order to drive volumes. Our belief is that with better customer pricing and a higher quality portfolio we can build a more scalable business.

The impact to revenue within the prospectus forecast period was greater than expected due to the rapid take up of the new rate card, and the continued trend towards a more premium credit quality customer throughout the period.

The new rate card was made available to all customers (including our existing customers). Our strong customer repeat rates coupled with our shorter-term loans contributed to the pace at which the portfolio yield shifted. We made no changes to our standard operating practice in that time.

The prospectus forecast did not anticipate such a rapid take up, particularly in our back book. Once the impact of the continued trend and portfolio shift became clear last week, we updated the market.

We recognise we were too slow in adjusting our rate card distribution to manage our yield. As Gail has indicated, we will be enacting improved processes and controls, and boosting our resource levels and capability in modelling and forecasting to address this going forward.

We've been asked whether the predictability and volatility of Prospa's earnings has changed.

We believe this is the case in the short term. As we continue to diversify our offering in different segments, products and geographies, the short-term predictability of the business model in relation to sources of growth gets more complex. However, we believe more diversified sources of revenue from multiple products, risk grades and countries will create more predictability and underpin shareholder value in the medium to long term.

We have a number of levers that we can adjust in our model such as rate, risk grade distribution and risk appetite. Some have a short-term impact and the effect of others takes longer, especially when there are a number of factors at play in a fast-growing business such as industry-wide and industry-specific seasonality.

Yield management will receive greater focus moving forward, and we intend to improve our capabilities and resources in this area.

Finally, there is a perception we may have moved away from the higher risk area of the market.

We made two credit risk related movements in 2019 that impacted revenue. Firstly, we took prudent steps this year to reduce our exposure in several segments of the building and trade industry that we believed would be negatively impacted by softer housing construction. We have always actively managed credit risk in this way to achieve a balanced risk/return trade off and have recently seen some of the risks in building and trade abate.

Secondly, while we have not completely moved away from our traditional customer base, this year we made a decision to reduce exposure to some of our lower credit quality segments as part of our rate card review. We are currently reviewing our risk appetite and pricing to see where we can expand our reach to meet the needs of these customers in a responsible way.

We will now comment on economic conditions and competitive dynamics.

Our portfolio continues to perform well, which indicates strong performance within the small business industry sectors we lend to. On a macro basis, we believe we are in the latter stage of the credit cycle and so we will remain prudent in our portfolio management.

The Federal Government is very supportive of increased competition and, as the size, strength and attractiveness of the alternative small business lending sector is growing, we are seeing a steady level of competition. However, Prospa remains the leader in the space with a high level of brand awareness relative to others and we expect to continue to leverage our leading position.

FY19 in review

The 2019 financial year was characterised by strong customer and originations growth, from all sources of our business with our customer numbers up 58% on the prior year to over 20,000 at the end of the period.

Total loan originations surpassed $500 million for the first time, up over 36% on the prior year.

Group revenue was $136 million, up 31% on the prior year.

This resulted in EBITDA of $6.8 million, primarily driven by:

- lower costs of funding;
- improved impairments; and
- investment in our growth initiatives.

Early loss indicators continue to trend down

Loan impairment expense was $30.6 million, 5.3% better than forecast. This was driven by an increase in premium risk segments and increased data to inform our credit decision engine. We now have over 74,000 application data sets, and the more data and performance history we generate, the more accurate and predictive our credit model becomes over time.

And this is reflected in our static loss rate, which has been very stable and within our 4 to 6% board mandated range.

Building a cohesive, customer focused platform

We are focused on building a cohesive customer-focused platform to help small businesses in different ways.

We provide cash flow products and services that allow small business owners to Grow and Run their businesses and Pay for goods and services.

We can help businesses GROW with a small business loan that facilitates investment and business-building. Our small business loans range from $5,000 to $300,000.

We can help businesses RUN with a line of credit up to $100,000 that helps small business owners manage their cashflow. Our line of credit product leverages our existing credit infrastructure and we've found that this product is complementary to the small business loan.

And now we can also help small businesses PAY for products and services using a B2B trade payments solution that offers an interest-free trade service.

But we are still at an early stage of growth: investing in our product range, investing in marketing, reaching more customers and growing our portfolio of small business customers.

Let me take you through what we're doing in each part of our business to improve our service offering to the small business community.

Investing in our core product

During the reporting period, we made a number of enhancements to our small business loan, including:

- Increasing the maximum loan amount from $250,000 to $300,000 – making Prospa MORE relevant to MORE small businesses needing MORE capital;
- Providing longer terms of up to 24 months for certain customers – which delivers more flexibility.

And, as discussed, in the final quarter of the financial year, we launched an updated rate card for the small business loan with simple annual interest rates from 9.9 to 26.5%.

Notwithstanding the short-term impacts on revenue recognition, from a long-term perspective, the new rate card is allowing us to service more customers across the market and to attract lower risk-profile customers (who are typically more price sensitive).

We're also providing a better customer experience, with 15% of applications assessed in real time, up from 8% last year, and we expect this to double again in the next period.

Increasing addressable market: Line of Credit

Line of credit is gaining momentum. The Line of Credit is a convenient and flexible source of funds between $2,000 and $100,000, with interest paid only on what customers use, while they use it.

We are leveraging our existing credit infrastructure and technology with this product. With smaller credit approval amounts and shorter payback periods we are maximising automation and self-service, allowing customers to manage their line of credit online or through our App.

As at 30 June, we had provided over $1.7 million in drawn facilities with an average utilisation of 68% and an average drawn balance per customer of $14,000. In October 2019 we formally launched this product and saw originations of over $10 million in the month.

Increasing addressable market: ProspaPay

ProspaPay progress is encouraging. ProspaPay is our new B2B trade payments solution that we launched in pilot mode in the second half of the year.

It allows approved customers to purchase goods from approved ProspaPay vendors valued at up to $20,000, with repayment terms of between three and nine months, on an interest-free basis.

We plan to continue investment in this product, including:

- enabling online and offline payments;
- selectively increasing the number of vendors; and
- integrating into a variety of digital platforms.

Increasing addressable market: New Zealand market expansion

Our expansion into New Zealand is exceeding our expectations. We estimate the potential opportunity in New Zealand to be NZ$4 billion plus per annum.

To give you some context for the momentum we have in this market, during the pilot phase we ran in August last year, we hit NZ$1million in originations in the first full month of operation. In Australia, it took us 14 months to hit that milestone. This is the benefit of being able to leverage our established systems and technology.

We are delighted we originated NZ$24 million of loans to New Zealand small businesses during the financial year. We have a TrustPilot rating in New Zealand of 4.9 out of 5 and we already rank first in the non-bank finance category.

At 30 June 2019, we had over 700 customers, with an average loan size of approximately NZ$27,000, and our customer base is diversified across a range of industry sectors.

We believe that our strong entry to the New Zealand market will allow us to continue to build scale and penetration into this financial year and beyond.

Market leading funding platform

During FY19 we added a further three funding warehouses, taking our total number to five – increasing our new funding capacity by $155 million. We also added two major Australian banks to our funding structures to support the ongoing future growth of the portfolio. This represents a significant step forward for our business and for the small business lending category in general.

In August 2019, we added our first funding warehouse in New Zealand, which was a NZ$45 million facility to fund our New Zealand portfolio. This marks another first for the Prospa funding platform and ensures that we can continue our acceleration into the New Zealand market.

Operating highlights

As Gail has touched on, we strongly believe our people are crucial to our success and we have invested in building a highly engaged team. We're proud that despite our growth, we've maintained a culture that nurtures talent, fosters collaboration and communication, and drives performance and development.

Our distribution partners also recognise we are best in class, with Prospa achieving a clean sweep of the Mortgage and Finance Association of Australia State Excellence Awards for Best Fintech Lender in 2019, and winning the national excellence award as Best Fintech Lender for the second year running, receiving this accolade across all states and territories in Australia. Prospa was also certified as a Great Place to Work.

Conclusion

In conclusion, we would like to thank you all for your support of the Company in FY19. While we are disappointed by our trading update, we don't wish to lose sight of the achievements we have made on our journey so far. We believe this is just the beginning. The financial services industry is changing rapidly, and our role in supporting small business is now even more vital. We enjoy the support of over 24,000 small business customers and appreciate your support as we continue our exciting journey.

We would also like to reiterate, as co-founders we maintain a meaningful stake in Prospa and consider ourselves aligned with our shareholders on delivering long term value.

In this spirit, and in light of the events of the past week, we (that is, Key Management Personnel: Greg Moshal, Beau Bertoli and Ed Bigazzi) have made the decision to forfeit our FY19 short term incentives under Prospa's Executive Incentive Plan. In addition, we (that is the Co-Founders: Greg Moshal and Beau Bertoli) will extend our escrow period by six months until after the Company's H1 FY21 financial results have been released to the ASX.

We hope our unwavering focus on our customers, our growth strategy and our commitment to creating long-term shareholder value will deliver confidence in Prospa's future.

ENDS

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