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GreenSky, Inc. (GSKY)

Q4 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you, and welcome to the GreenSky Fourth Quarter Fiscal 2018 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. We are webcasting this call live on the GreenSky Investor Relations website. After the completion of the call, a recording of the call will be made available on the same site.

I would now like to turn the conference over to Rebecca Gardy, Senior Vice President of Investor Relations at GreenSky. Please go ahead.

Rebecca Gardy
Senior Vice President, Investor Relations, GreenSky, Inc.

Thank you, Crystal, and good morning, everyone. Earlier this morning, GreenSky issued a press release announcing results for its fourth quarter and fiscal year ended December 31, 2018. You can access this press release on the Investor Relations site of the GreenSky website. Joining me on the call today are David Zalik, Chairman and Chief Executive Officer; Gerry Benjamin, Vice Chairman and Chief Administrative Officer; and Rob Partlow, Chief Financial Officer.

Before we get started, let me remind you that our presentation and discussions will include forward-looking statements. These are statements that are based on current assumptions and are subject to risk and uncertainties that could cause actual results to differ materially from those projected. We disclaim any obligation

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to update any forward-looking statements except as required by law. Information about these risks and uncertainties are included in our press release issued this morning as well as in our filings with regulators.

We will also be discussing certain non-GAAP financial measures on today's call. These non-GAAP measures are not intended to be considered in isolation from, a substitute for or superior to our GAAP results, and we encourage you to consider all measures when analyzing GreenSky's performance. These non-GAAP measures are described and reconciled to their GAAP counterpart in the presentation materials, the press release dated March 5, 2019, and on the Investor Relations page of our website.

Following our prepared remarks, we will take your question. As a courtesy to other participants, please ask no more than two questions. And in the event you have additional questions that are not covered by others, please feel free to re-queue and we'll do our best to come back to you. Thank you for your cooperation on this. And finally, a replay of this call will be available later today on our website at greensky.com.

And with that, I will now turn it over to David.

David Zalik

Chairman & Chief Executive Officer, GreenSky, Inc.

Thanks, Rebecca. Good morning, everyone, and thank you for joining us today. Before I begin, I'd like to take a moment to thank both the GreenSky leadership team and GreenSky's 1,100-plus associates for all their hard work that resulted in a great 2018 and their continued focus as we head into 2019. I will start by providing a brief overview of our 2018 performance and update on key business initiatives before turning it over to Gerry to discuss our key operating metrics, and then to Rob to review our financial results in greater detail.

As highlighted on slide 4, I'm very pleased that GreenSky met our 2018 outlook led by transaction volume of $5.03 billion, which is a 34% year-over-year increase. This strong growth rate was achieved in the year when solar originations declined from as high as 20% in late-2016 to less than 5% in 2018. This growth also reflects strong demand in our growing elective healthcare vertical, which now represents approximately 10% of total monthly transaction volume. GreenSky's strong growth in transaction volume, our asset-light model, and operating efficiencies culminated in adjusted EBITDA of $171.5 million for the year, representing an adjusted EBITDA margin of 41%.

Turning to slide 5, let me touch on a few of the key highlights of our first year as a public company. In August, we entered into a comprehensive strategic alliance with American Express. The first phase of this alliance, whereby American Express will enable eligible domestic merchants that accept American Express Cards to access GreenSky's digital loan technology platform launched in September 2018. Through the end of the year, GreenSky has received over 2,000 home improvement merchant referrals from American Express. In February of this year, this merchant referral program was extended to elective healthcare providers.

In the next 60 days, we will launch the American Express and GreenSky Consumer Direct home improvement installment loan pilot program in five cities: Atlanta, Chicago, Dallas, Los Angeles and Tampa. We are excited about this next phase of our alliance and we look forward to sharing results as they post. In January 2019, we launched our first revolving credit product for our growing network with elective healthcare providers. Our current lineup of both revolving and installment loan products positions us to compete favorably with all major players in the elective healthcare vertical. We are currently piloting this product with select providers with a phased nationwide roll-out planned through the first half of fiscal 2019.

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Given our minimal elective healthcare market share and our emerging market position in the home improvement vertical, we look to achieve increased market penetration in 2019. Additional future growth lies in entering attractive, new industry verticals, including specialty, retail and e-commerce, each with a focus on large ticket purchases facilitated for prime and super-prime borrowers. From a technology and product development standpoint, our innovation pipeline has never been more robust, from enhancing feature functionality to optimizing the user experience for both our affiliated merchants, leveraging our proprietary technology platform and program borrowers alike, we continue to widen our technology mode.

Examples of new product releases to be hitting the market over the coming quarters include automated merchant [ph] porting (00:05:51) tools, CRM prospecting and account management tools, sales order entry integration tools, and digital lead generating and customer marketing tools. To further advance the GreenSky program borrower user experience, we will be further leveraging voice recognition technology, including innovative and highly intuitive Siri and Alexa integration. Each of these product innovations is singularly geared toward enhancing both the volume and pace of frictionless customers being generated by and for both our merchants and program borrowers.

I'll now turn it over to Gerry. Gerry?

Gerry R. Benjamin

Vice Chairman & Chief Administrative Officer, GreenSky, Inc.

Thanks, David. As David touched upon, our overall performance in fiscal 2018 was solid and we achieved significant growth over 2017 in each of our key business metrics. Our active merchant network grew to nearly 15,000 home improvement contractors and elective healthcare providers, a growth year-over-year of 37%. We continue to enjoy greater than 100% dollar-based merchant retention. Of note, our 2008 (sic) [2018] (00:06:57) cohort of enrolled merchants was by far the strongest in the company's history as measured by its year-one origination dollars.

We added two new Bank Partners to our lending consortium, BMO Harris Bank and Flagstar Bank. Combined with increases in funding commitments by our existing Bank Partners, we ended the year with aggregate commitments of $11.8 billion, reflecting an increased commitment level of $3.8 billion since December of 2017. Current unused Bank Partner commitments at year-end totaled $4.8 billion.

As you'll see on slides 10 and 11, we maintained an attractive consumer profile. For all loans originated in our platform during 2018, the dollar-weighted average consumer credit score was 768. Consumers with credit scores over 780 comprised 33% of the loan servicing portfolio at year-end, and over 85% of the year-end loan servicing portfolio consisted of consumers with credit scores north of 700. Importantly, I want to stress again that GreenSky's Bank Partners have never relaxed their credit standards in an attempt to stimulate transaction volume growth.

As a result of our focus in prime and super-prime borrowers, we see very stable delinquencies across all vintages of the Bank Partner portfolios. In our fourth quarter, 30-day delinquencies came in as expected. As noted on slide 10, for the fourth quarter 2018, 30-day delinquencies were 1.48% of balances with a payment due, just 3 basis points higher than the fourth quarter of 2017. In the first quarter of 2018, 30-day delinquencies were 1.18% and we expect a similar rate in the first quarter of 2019. These trends mimic consumer credit seasonality whereby delinquency rates dropped in part due to the timing of individual income tax refunds.

Noting on slide 12, in addition to a stable credit profile, we are pleased that the lifetime aggregate economics of fourth quarter loans originated through the GreenSky platform as measured by the Origination Productivity Index,

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or OPI, also remained incredibly stable. You've heard us say many times over that we're truly agnostic as to what financial products are offered by merchants to their customers, and this is reflected again in our OPI, which remained flat relative to the third quarter at 22.2%.

GreenSky enjoys a balanced capital allocation strategy, including investing in continued profitable growth, as well as now returning capital to shareholders through share repurchases. On our third quarter call, we announced that the GreenSky board had authorized the purchase of up to $150 million of the company's Class A common stock. Through the end of 2018, we successfully repurchased 4.7 million shares of Class A common stock at a cost of $43.9 million. We repurchased 1.2 million shares more at an incremental cost of $12.7 million through February 28, 2019. We continue to believe that share repurchases in today's price vicinity are far too compelling an opportunity to pass upon.

And with that, I'll turn it over to Rob to review our financial performance and provide our update on our 2019 guidance. Rob?

Robert G. Partlow

Chief Financial Officer & Executive Vice President, GreenSky, Inc.

Thank you, Gerry. Turning to slide 13 of the supplemental deck we posted on our IR website, transaction volume increased 23% to $1.3 billion in the fourth quarter of 2018 relative to the prior year. Solar originations were approximately $80 million lower in the fourth quarter of 2018 than in 2017. Excluding solar originations, we grew transaction volume by 34% during the fourth quarter over 2017. And on a full year basis, transaction volume increased 34% to $5.03 billion. The average transaction fee for the full year was 6.9% compared to 7.4% in the fiscal 2017, reflecting the reduction of solar originations which carry a higher average transaction fee than non-solar volume.

We are very pleased that the average transaction fee for the fourth quarter of 2018 increased to 7.1% from 6.9% in the third quarter, and we expect it to stay in the 7% to 7.1% range for fiscal 2019. However, in the first quarter of every year, we apply a volume-based promotional allowance for certain sponsors, and therefore, we expect our first quarter 2019 transaction fee rate of approximately 6.8%. Notwithstanding, we do expect that the net transaction fee rate to be in the 7% to 7.1% range for the full year.

The average loan servicing portfolio increased 38% in the fourth quarter of 2018 to $7.1 billion from $5.2 billion in the prior year. For the full year, the average loan servicing portfolio increased 40% to $6.3 billion from $4.5 billion last year. And consistent with the growth in our loan servicing portfolio, servicing fees increased 41% to $65.6 million and remained at 1.04% of the average loan servicing portfolio. Fourth quarter total revenue grew 22% to $109.7 million in 2018 from $89.8 million in 2017. And for the full year, the total revenue grew 27% to $414.7 million from $325.9 million last year.

On a breakout on slide 14, cost of revenue is made up of three distinct components: servicing costs, origination costs, and a fair value change in FCR liability. Servicing-related expenses totaled $35.5 million in 2018, which was 0.6% of the average loan servicing portfolio. We expect servicing expenses of about 0.5% of the average loan servicing portfolio in 2019. Origination-related expenses for the full year 2018 were approximately 0.6% of 2018 originations. We expect these costs to grow with originations and remain consistent at approximately 0.6% throughout 2019. The fair value change in the FCR liability was $37.3 million or 2.1% of the average loan servicing portfolio in the fourth quarter of 2018. For the full year, the fair value change in FCR liability was $96.9 million or 1.5% of the average loan servicing portfolio, up from 1% in 2017.

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On slide 15, we delineate the activity within the FCR liability by quarter which contributes to the fair value change in the FCR liability within cost of revenue. However, to best understand the drivers of this expense, I think it's helpful to break down these line items into several components as we have done on slide 16 of our presentation. The increase in the fair value change in the FCR liability is driven by: first, the continued growth within our loan servicing portfolio of deferred interest loans in their promotional period, as a result of both the growth in originations in home improvement as well as the growth in elective healthcare, which presents a much higher mix of deferred interest products; second, higher build APRs on deferred interest loans in response to higher bank cost of funds; and third, the variability in receipts, which is impacted by the timing of our transfers in charge-off receivables as well as the seasonality of consumer defaults in our Bank Partner portfolios.

We typically see lower charge-offs in the second and third quarters which result in higher incentive payments. And in the fourth and first quarters, we typically see higher consumer defaults, thereby lowering our incentive payments. These factors are the primary drivers of the increase in the fair value change in the FCR liability year-over-year as well as from Q3 to Q4 in 2018. As we look forward, we expect the fair value change in the FCR liability to increase as a percentage of the average loan servicing portfolio by approximately 40 basis points in 2019 over 2018's 1.54%, driven by higher build APR on deferred interest loans in their promotional period as well as the continued growth of the elective healthcare's deferred interest loan portfolio.

For the first quarter of 2019, we expect the seasonal effects of consumer credit to keep receipts as a percentage of the average loan servicing portfolio at a similar rate as the fourth quarter 2018 of 1.62% before increasing in the third and fourth quarters as consumer defaults at lower. For those of our listeners who are interested in unpacking the components of the fair value change in FCR liability on slide 16, we provided details of the quarterly receipts and settlements as well. I'd be happy to jump in on a separate call with any of our analysis and analyst or investors wanting to take a deeper dive into these components, including how best to model the quarterly variability of the fair value change in the FCR liability.

Jumping back to slide 13, operating profit totaled $152.8 million for 2018. Other expenses net of other income were $19.3 million for the full year 2018, an increase of $12.3 million primarily due to the inclusion of a full year of interest expense on our term loan in 2018, the $50 million increase in the principal loan balance during the first quarter 2018, and the impact of higher labor rates. Pre-tax net income for the full year was $133.5 million, $5.2 million lower than 2017 due to the combination of items previously noted, including $12.3 million of higher interest expense, the 0.5% decline in the transaction fee rate, and the higher fair value change in FCR liability which offset the benefit of higher transaction volume in 2018.

Income tax expense of $5.5 million represents a 4.1% effective tax rate on the income attributable to our public C-corporation. As a result, 2018 net income of $128 million are not fully burdened by our long-term expected tax rate. Therefore, we also use the measure of pro forma net income which taxes all of our earnings. Pro forma net income was $21.5 million for the fourth quarter of 2018 and $109.1 million for the full year 2018 and assumes an effective tax rate for the full year of 19.7%.

On a fully diluted basis, earnings per share was $0.11 for the fourth quarter of 2018, adjusted EBITDA was $33.1 million for the fourth quarter of 2018 and represented 30% of revenue. As previously noted, higher transaction volume in 2018 was offset by lower average transaction fee rate, higher fair value change in FCR liability due to the continued growth of our deferred interest loan originations, higher build on APR on deferred interest originations, and lower charge-off receivable proceeds. For the full year, adjusted EBITDA increased by 8% to $171.5 million which was higher than the midpoint of our November guidance, up from $159.4 million in 2017. The adjusted EBITDA margin was 41% for the full year of 2018. And finally, as referenced in the appendix of our

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earnings presentation, free cash flow for the fiscal 2018 was $224 million, representing 205% of our pro forma net income for the year.

Now, let me turn to our guidance for 2019. Based on the company's fiscal 2018 performance, its 2019 planning and current market conditions, we reiterate our previously announced guidance of transaction volume to increase 27% to 35% over 2018 to between $6.4 billion and $6.8 billion, adjusted EBITDA to grow between 22% and 31% over 2018 to between $210 million and $225 million. We're also providing additional fiscal 2019 guidance as follows: revenue to grow 30% to 38% over 2018 to between $538 million and $572 million; pro forma net income to grow between 17% and 28% over 2018 to between $128 million and $140 million using an effective tax rate of 22.5%. We also expect our fully diluted shares to average 185 million for 2019.

As a reminder, we do have substantial seasonality in our business. As previously discussed, our cost of revenue is higher in the fourth quarter and first quarters, and lower in the second and third quarter due to the seasonal patterns of consumer credit. In addition, our transaction volume is weakest in the first and fourth quarter of each year, which directly impacts our revenue. Over the last several years, we have seen a very consistent seasonal pattern, and for 2019, we expect that seasonal pattern to continue. For modeling 2019 originations, we expect quarterly originations to represent approximately 19%, 26%, 28% and 27%, respectively, of total expected originations.

And with that, I'd like to turn it over to Rebecca to set up the Q&A.

Rebecca Gardy

Senior Vice President, Investor Relations, GreenSky, Inc.

Thanks, Rob. That concludes our prepared remarks. Before we move to questions, I wanted to remind listeners that Gerry Benjamin and I will be attending the Raymond James Institutional Investors Conference tomorrow in Orlando and our presentation is at 9:15 Eastern Time. The presentation will be webcast and available on GreenSky's Investor Relations website. And finally, as Rob mentioned, we are happy to take follow-up modeling questions offline.

Operator, please let's have our first question.

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from James Schneider from Goldman Sachs. Your line is open.

James Schneider
Analyst, Goldman Sachs & Co. LLC

Q

Good morning. Thanks for taking my question and congratulations on the solid quarter. I was wondering if you could maybe give us a little bit of color on how you're thinking about 2019 from an end market demand perspective from a transaction volume perspective in terms of the relative growth you're assuming for home improvement and elective healthcare and to what extent those are different assumptions than what you had maybe three months ago? Any color on that would be appreciated and may be kind of sense it out how big elective healthcare to be by the end of the year will be great. Thank you.

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

Hi. Good morning. Glad to have you on the call. Just want to do a sound check, make sure you can hear me okay.

Gerry R. Benjamin
Vice Chairman & Chief Administrative Officer, GreenSky, Inc.

A

Fine.

James Schneider
Analyst, Goldman Sachs & Co. LLC

Q

Yes, I hear you fine. Yes.

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

So, in terms of demand, on the demand side, we obviously spent a lot of time with our merchant and provider customers, and our merchants are reporting just a fantastic growth already this year for their businesses, great demand. We're engaged with many, many of our customers about expanding their marketing appetite and we're seeing just a terrific demand. And on top of that, just the fact that we are so incredibly underpenetrated not only in home improvement, but certainly in healthcare, we feel very, very good about the demand. I think something that does seem to confuse people is there is no correlation between our business and housing starts. If anything, less inventory availability drives more home improvement demand. So, we're not seeing any indication of softness from our providers and merchants. Jim, did I answer your question?

James Schneider
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Yes, you did. And how big you think elective healthcare will be by the end of this year, let's say?

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

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Gerry?

Gerry R. Benjamin
Vice Chairman & Chief Administrative Officer, GreenSky, Inc.

A

So, we want to sort of be cautious in that we don't plan on breaking out elective healthcare discretely and we don't view that as a separate segment. But we have given guidance that in fact healthcare has emerged to represent 10% of originations in the first week of January. We expect given the run rate at the end of 2018, it's reasonable to expect that business to double in the current year. So, we're expecting significant growth in the elective healthcare business with strong visibility, Jim.

James Schneider
Analyst, Goldman Sachs & Co. LLC

Q

Okay. It's very helpful color. Thank you. And then maybe as a follow-up, it's more of a clarification, but I'd like to – you obviously gave some good data points about the American Express partnership and it sounds like that's off to a good start. I just want to clarify, first of all, that the Amex partnership is not included in the 2019 guidance as it stands now. And to the extent that it does ramp quickly, would that have any kind of significant impact on the transaction fee rate in your financials as it ramps? Thank you.

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

Yeah. I can speak to that. It's not included in any of our models. It's still testing. It's still a pilot. We're very excited about it. It would have a positive impact on both rates. It would not have a negative impact on rate or average rate. So, it's both – it would only be upside on transaction volume, merchant growth and take rate.

Gerry R. Benjamin
Vice Chairman & Chief Administrative Officer, GreenSky, Inc.

A

Let me add just a bit to that. James, as you recall, there is really little that our sales and marketing team is going to do in 2019 that's going to impact our 2019 results. The year is highly visible and really baked based on those cohorts of merchants and elective healthcare providers that are already on our platform. In the best case as we have merchants and elective healthcare providers throughout the year, on average anybody added is going to be only on the platform for six months in the first year and it takes about six months for folks to ramp. So, this really isn't a story about a rocket ship of new originations coming from 2019 marketing activity. We're going to reap the benefits of all the work that's been done in the last three, four years building these merchant cohorts. It will be no different, irrespective of how successful that Amex alliance is. It will take time.

James Schneider
Analyst, Goldman Sachs & Co. LLC

Q

That's great. Thank you very much.

Operator: Thank you. Our next question comes from Andrew Jeffrey from SunTrust. Your line is open.

Andrew Jeffrey
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Hi. Good morning. Appreciate you taking the question. Rob, I wonder if you can comment in little more detail about how the cadence of 2019 quarterly results is likely to look. Specifically, it sounds like 1Q and 4Q were

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probably the lowest quarters of the year, just trying to get a sense of how to think about changes in delinquencies and loan losses, and how to model those as they affect your results.

Robert G. Partlow
Chief Financial Officer & Executive Vice President, GreenSky, Inc.

A

Certainly. Yeah. So, as I kind of laid out in kind of my prepared remarks, certainly, the seasonality of consumer credit certainly affects the fourth quarter and the first quarter receipts line item, and so performance payments are – or incentive payments are reduced. Now, take what we, what I – we fully expect that as the percentage of the servicing portfolio that the receipts will be very similar in the first quarter as are in the fourth quarter which is kind of a consistent pattern. And we also would expect those – that receipts line item to move up in the third and fourth quarters similar to prior years as the consumer defaults add. So, that's kind of the core way to think about that. That effect has kind of a direct – the changes in the receipts has a direct impact on that fair value change in the FCR liability expense line item. And then [indiscernible] (00:27:39) that...

Andrew Jeffrey
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Yeah. So...

Robert G. Partlow
Chief Financial Officer & Executive Vice President, GreenSky, Inc.

A

...we also think, we look at the kind of overall trend in the FCR line item to be moving up just really because of the growing servicing portfolio of deferred interest products and the growing – the higher APR in those deferred products. So, the combination of these two items on slide 16, kind of pull together kind of where we expect the trend to move to.

Andrew Jeffrey
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay.

Robert G. Partlow
Chief Financial Officer & Executive Vice President, GreenSky, Inc.

A

I think one of the things which I would focus on typically is looking at both, lastly on slide 16, where we look at the, what I'd call – with the reference to number A was actually where you can see the expense of the build-up of the deferred interest portfolio and the expense related to that. And you can see that, we do expect that component to grow over the next year. We can certainly, at your convenience...

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

Andrew, I would add – thank you, Rob. Andrew, I would add to that. From our perspective, this isn't the seasonality that we've seen every year for the last decade, our – most volume are Q2 and Q3 every year. And so, we see the same seasonal trends in terms of volume and growth. And certainly, everybody will see the same seasonality in terms of delinquency which overall stays very low, but it's certainly even lower in Q2 and Q3.

Andrew Jeffrey
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay, helpful. Thank you. And...

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Robert G. Partlow
Chief Financial Officer & Executive Vice President, GreenSky, Inc.

A

And we can certainly go into more detail offline. I think the slide 16 really does give you the tools to think through the seasonal impact that David highlighted and I've highlighted in the quarters to come.

Andrew Jeffrey
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. I appreciate that. Thanks. And then, David, maybe you can comment a little bit on the competitive environment. You're obviously doing very well in terms of growing your share in home improvement sort of regardless of macro. We saw JPMorgan introduce perhaps a new pay-as-you-go product this morning. There are others in the market. Can you just talk about how GreenSky will likely fare as more entrants coming to the market? Maybe talk about some of the things that distinguish you a little bit.

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

Yeah. So, let's start on the easy one. Are you referencing to the Forbes article relative to JPMorgan's so-called point-of-sale product?

Andrew Jeffrey
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Yeah.

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

Yeah. We were scratching our head, because we didn't see anything about that actually being point-of-sale. It just appears to be a personal loan product wrapped inside a credit card balance. There is actually no point-of-sale functionality referenced in any of the materials related to that article. So, we think it's a wonderful service for consumers that want debt, but it's not for merchants, it's not promotional credit, it's actually not point-of-sale. So, I do think that as GreenSky gets bigger, lots of people want to wrap themselves in the banner of point-of-sale and we think that's great, but you actually have to deliver a tremendous amount of real-time point-of-sale technology both to merchants and consumers using mobile technology in an instant and paperless and digital fashion. So, that's a data point.

In terms of the competitive set, we've been building technology on point-of-sale for multiple verticals now for a decade and that gives us a head start and we're not going to slowdown. We spend dozens and dozens of millions of dollars in the technology every year. This is all we do. So, it's a tremendous advantage over large money center financial institutions that have $1 trillion balance sheets and probably a few other priorities. And we see ourselves as partners to super-regional banks providing the technology and partnership with their diverse local deposits and relationships.

So, a couple of competitive advantages, where all the technology that we've built and delivered and deployed is a great start, all the technologies that we have in the pipeline now, all the additional tools that we're providing to merchants, the merchants rely on as a core part of their business, makes the business even stickier, creates [ph] a bigger loan (00:32:02). And then add to that, our emerging ability to bring customers – incremental customers to our merchant business is an incredible value-add and differentiator. And I'll just conclude with one of our largest network of customers recently went through an extensive RFP and talked to the whole country and has decided to

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stay with GreenSky after evaluating all of the different pieces of value-add in technology and services that we provide.

Andrew Jeffrey
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Great. Thank you.

Operator: Thank you. Our next question comes from Chris Donat from Sandler O'Neill. Your line is open.

Christopher Roy Donat
Analyst, Sandler O'Neill & Partners LP

Q

Good morning. Thanks for taking my questions. David, since you just mentioned the bank partnerships, I wanted to ask about SunTrust. And I know we're early days here, but with SunTrust being a key partner for you and then also merging with BB&T, I'm just wondering if you've had any discussions or early indications? I recognize that SunTrust is important for GreenSky, but for the GreenSky – sorry, the merged SunTrust and BB&T, you guys would be a pretty tiny percentage of that pro forma balance sheet. Just wonder if there is any update?

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

Yeah. So, we obviously have a wonderful relationship with SunTrust going back almost a decade and we've great respect for BB&T. I think the impression that we've gotten in and the – our thought is, any indication is that their demand and appetite for more super-prime customers would only grow. Certainly, that's a long time, but I think it's great that it's a merger of equals and we have such a longstanding relationship with one part of that MOE. So, our impression thus far is we wouldn't be surprised if demand grows, but frankly there's so much demand from the rest of our bank network that we're oversubscribed, if you will, as it already is. So, we see as a net positive from our perspective.

Christopher Roy Donat
Analyst, Sandler O'Neill & Partners LP

Q

Okay, got it. And then just want to ask one question about the delinquencies so far in the first quarter. It looks like it's on track with seasonality of prior years. There's been some hand-wringing in the market place though about – on a macro level about the pace of tax refunds being different from prior years. I understand that tax refunds fit into some of your seasonality. I'm just wondering if you're seeing anything different in consumer behavior related to tax refunds or if it's similar to the prior years, just because of what's going on in the broader macro environment.

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

Yeah. I was with our risk folks yesterday on a call and let me just summarize, we're very pleased with what we're seeing not only from a credit performance standpoint, but just also from the demand side, both from the merchant and the consumer. Notwithstanding the incredible amount of [ph] trust on the dire (00:35:26) situation in the world, American consumers appear to us to be very strong certainly have chosen our business.

Christopher Roy Donat
Analyst, Sandler O'Neill & Partners LP

Q

All right. That's helpful and good news, too.

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Operator: Thank you. Our next question comes from Ashwin Shirvaikar from Citi. Your line is open.

Andrew Schmidt
Analyst, Citigroup Global Markets, Inc. (Broker)

Q

Hi, guys. This is Andrew Schmidt on for Ashwin. Thanks for taking my question and also thank you for the increased disclosure for the fair value change in FCR liability. If we could dig a little bit into that, and appreciate the comments on credit and the seasonality, and it sounds like things are trending pretty well thus far. But what are the expectations for credit quality for the full year? If you could just talk about what's embedded as it relates to the FCR liability that would be helpful.

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

Gerry, who don't you take that?

Gerry R. Benjamin
Vice Chairman & Chief Administrative Officer, GreenSky, Inc.

A

Yeah. I'll give you a quick overview and let Rob supplement it with a little more detail. The real driver in terms of the FCR liability, first and foremost, is the percentage of our servicing portfolio that are the deferred interest loans and promotions. So, on a macro or high level, as our healthcare – elective healthcare business grows as a percentage of our total mix, you'll expect our deferred interest mix of loans to grow, so that at a very high level will create greater FCR. When we look at the seasonality that we spoke to and then think about the full year, Rob has given some pretty discreet guidance as to how the quarters will progress throughout the year, but Rob, if you want to talk from a full-year point of view how you're thinking about FCR, feel free to jump in.

Robert G. Partlow
Chief Financial Officer & Executive Vice President, GreenSky, Inc.

A

No. I think as Gerry highlights, the big driver, when I talked about the FCR – fair value change in the FCR liability that expense increasing by about 40 basis points year-over-year is really the growth of our deferred interest portfolio, which is a function of both the growth of our home improvement portfolio of deferred interest products, as well as the growing elective healthcare which has a much higher mix of deferred interest products, and that's a primary driver of that kind of overall increase.

You do see some seasonality in consumer credit and that kind of drives the movement in the receipts line item. But the biggest thing which we're seeing kind of for 2019 really is just that growing deferred interest portfolio. The overall credit environment we expect to be very consistent with the current credit environment that we're in and that's what's based in our forecast. We're seeing no indications that there are any changes in that environment, as Gerry alluded to or David alluded to, we're seeing very stable consistent delinquency patterns, early stage and late stage. So, we continue to be, I think that the consumer – the American consumer continues to be very resilient.

Andrew Schmidt
Analyst, Citigroup Global Markets, Inc. (Broker)

Q

Got it. Thank you. That's helpful. And I appreciate the commentary on the new addressable markets, e-commerce being one of them. Wondering, if you could just comment on how, if at all, the platform needs to adapt to address

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the e-commerce opportunity. And then, obviously, there's a few embedded players in that space still lots of room for growth. But what would be GreenSky's differentiation there? Thank you.

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

Great question. So, the first thing that we're seeing is as we're getting market share is, GreenSky is uniquely situated in that, we have a fully integrated omni-channel point-of-sale, point-of-search, in-store, in-home, on a mobile device, on a website, in a showroom platform. We're going to figure out a way to say that in a fewer words. But the ability to go to a retailer and offer an integrated credit solution that works for both in-store and online sales that can start in a showroom and end online or the other way around as already proven to be a fabulous differentiator, the fact that we have tools and API integration to allow people to promote monthly payments and attractive promotions as part of the catalog.

One thing you'll notice about, I think the general competitive landscape is it tends to be – historically for us, subprime and small ticket. GreenSky is taking a very different approach where it's actually about commerce, not credit. And what that means to us is we're trying to enable people to translate a $2,000 purchase into an affordable $89 monthly payment at a very responsible interest rate that's left in credit cards. Whereas the most e-commerce providers you're talking about $300, $500 average take a 29% APR, completely different business. That to us is extending credit to people who are credit challenged, and that is not our mission. Our mission is all about commerce and helping businesses grow and delighting their customers.

Andrew Schmidt
Analyst, Citigroup Global Markets, Inc. (Broker)

Q

Got it. Thanks, guys. Appreciate the commentary.

Operator: Thank you. [Operator Instructions] And our next question comes from Tien-Tsin Huang from JPMorgan. Your line is open.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

Good morning. Thanks for all the details. I just want to check on the visibility on the transaction fee rate. I got the Q1 and full-year number. But just with the solar outlook and what you mentioned on health which has a higher – carries a higher fee rate, I'm curious what those dynamics are to get to the 7.0% to 7.1% for the year?

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

Yeah. So, thank you, and by the way, good morning. I think the most important thing is understanding where we are right now and what we've seen is incredible stability – just to remind everybody, incredible stability in our non-solar business. It has gone up 20 basis points over the last quarter. In terms of just even non-solar, overall, Q4 we were already at 7.1% and it's still inching up a little bit. So, we're already at 7% – above 7.1%. We feel really good about that. Q1 is a literally one-month phenomenon, because we've got promotional funds for some big partners that we expense in Q1. But seeing the trend in the mix and stability, solar is already down below 4%. It's been stable there for now finally the last two quarters. So, we don't see anything drop – bringing it down and we only see upside.

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Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

Okay, great.

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

So, and I think the punch line is...

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

Go ahead.

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

...we're projecting 7.1% for the year, 7.1% I believe for the year, we're already there.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

Yeah, understood. So, I know a lot of good questions have been answered already. But maybe, David, just want to ask your priorities, if you could rank them? There's a lot going on. You talked about e-com, big growth in elective medicine, you got the Amex piece rolling out, I'm sure you've some other partnerships you're working on as well. Just how would you rank the – where are you spending your time and priorities for the year?

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

Yeah. So, I spend my time on talent and product, and certainly always being a professional paranoid when it comes to risk. But the growth strategy for GreenSky I think is very clear: grow home improvement, grow healthcare, continue to grow and develop both e-commerce and specialty retail. And then, there is a category of tools and technology that provide services to our merchants and to our consumers, and we see Amex as a piece of that, and that is anything from additional products and services for our now more than 2 million consumers, working with our banks to develop other products, leveraging our technology and user experience, and then partnering with a great company like American Express as it relates to driving more consumers to our merchants.

You can see how that would be very much appreciated by our merchant network, another differentiator, tremendous amount of technology goes into making those integrations very elegant. So, home improvement, healthcare, e-commerce, specialty retail, and additional tools and products for our merchants and consumers, which creates more opportunities for our banks.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

That's great. Thank you.

Operator: Thank you. Our next question comes from James Faucette from Morgan Stanley. Your line is open.

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James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you very much. A couple of questions for me, and I think you've touched on some of these subjects, but I want to make sure that at least I'm clear on how these are developing. If I look at kind of the 2019 targets that you've set for originations versus revenue, et cetera – at least compared to our model, it seems like the revenue associated with originations is a little bit different than we thought. And I suspect that's probably related a little bit to the mix that is going to deferred interest loans versus other types. Can you just talk about what has been happening and give an update on what that mix looks like, especially after some of the pricing changes that were implemented in the second half of 2018?

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

It's a great question. I actually think the best thing to do would be to sit down and work with you and your team on the model. Gerry, Rob, you guys want to make some general comments, but then we'd really like to, James, provide you with some additional support.

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

Yeah. Yeah. Sure.

Gerry R. Benjamin
Vice Chairman & Chief Administrative Officer, GreenSky, Inc.

A

Yeah. No. I'm not clear kind of from a revenue perspective, where you're seeing from a...

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

Well, I just – yeah, just the question is just from a mix perspective or have you seen a discernible change in mix between deferred interest loans and other types of loans as you implemented pricing changes?

Gerry R. Benjamin
Vice Chairman & Chief Administrative Officer, GreenSky, Inc.

A

Yeah, absolutely not. We've actually seen a pretty consistent mix on the home improvement space. One of the things we have highlighted is where we're seeing that consistent mix – you'll see some shifts between 12-month and 24-month or 18-month type deferred products, but that's it. We do see – one of the things we do see is we continue to grow healthcare, and to a certain degree also in specialty retail side, we do see a higher mix of deferred product in those channels. So, as those take up a greater share of our business, that will also drive kind of the mix as well.

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

Got it. And then, you also talked about how you have a lot of – you certainly have enough capacity from a bank and Bank Partners' perspective right now. How are you thinking about the pace at which it makes sense to continue to add new Bank Partners and continue to grow that capacity? Should we expect that that capacity grows faster than the overall rate of origination growth or do you want to improve or increase your utilization before you really do that?

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David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

Great question. Our perspective now is we have so many large super-regional banks, great partnerships. There is so much opportunity and demand from our existing partners, and so much opportunity to expand the relationship into other products and other services. We feel really good where we are now. Anything else we would do would be purely opportunistic, and an American Express type partnership where there are additional services and offerings and opportunities that go along with it.

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

Great. And then, last question – oh, sorry.

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

It's just a demand from our existing partners.

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

Yeah. And then, sorry, last question for me is that, late in 2018, it look like we're going to be in a pretty persistently rising rate environment in 2019. Now here at the beginning of the year, that doesn't seem to be so much the case. Can you just talk a little bit about how you've factored into your 2019 outlook the changes in interest rates and what kind of your assumptions that's are around that and what you may have to do with pricing and hitting hurdle rates, et cetera?

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

Yeah. So, it's really interesting. When rates were going up, we told people rates do not directly impact us and they don't impact our margin. When rates go down, I'm going to tell you the same thing, rates do not directly impact us and affect to our margin. And when rates are flat, we really like it, because it means there is no noise and no distraction for our merchants and for our sales organization. So, we certainly assumed a couple of more rate increases. That just create some friction, but it's a pass-through. So, for us, we don't really mind where interest rates are. It just creates a little bit of friction and noise and extra work for our sales organization when they raise three or four, five times in a year.

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

That's great. Thank you so much.

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

Thank you.

Operator: Thank you. And our next question comes from Rob Wildhack from Autonomous Research. Your line is open.

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Robert Wildhack
Analyst, Autonomous Research

Q

Good morning, everyone. If I look at the 2019 guidance for adjusted EBITDA, the implication is for a slower year-over-year margin decline than you saw this year. So, what are the drivers of the improvement in that trend, and then how should we interpret that as it pertains to the longer-term earnings and margin profile of the business?

Robert G. Partlow
Chief Financial Officer & Executive Vice President, GreenSky, Inc.

A

What a great big broad question. Look, I think, first, not having the noise of solar is really great, because from a – on a relative basis when as much as 20% of your business, at 13% transaction fee evaporates to 4% by design that will, on a relative basis, make anything look not so good. But I think as we get bigger, get economies of scale, get some of the benefit, I think something that's lost on a lot of folks is the millions and millions of dollars that we're spending on further growth going into new markets, building new products. So, as those things start generating impact, it brings things back in.

Gerry, do you want to add anything to that?

Gerry R. Benjamin
Vice Chairman & Chief Administrative Officer, GreenSky, Inc.

A

No. I think you hit it, Rob. Any detail you want to add?

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

A

No. I think we've kind of walked over the components of that kind of drive our forecast. And one of the things, our goal was – through this call was to be more precise about the different pieces and where we expect the kind of core pieces to go. So, I think you kind of have – hopefully, through all the discussion we had today, you have the building blocks of not only the volume as well as the transaction fees, but also the FCR, and we can certainly happy to talk through in more detail at any point. Any other questions?

Robert Wildhack
Analyst, Autonomous Research

Q

Okay. Thanks. And then just looking at the revenue outlook, I mean what do you think the key items are that move or determine whether you're at the low end or the high end of that range?

Gerry R. Benjamin
Vice Chairman & Chief Administrative Officer, GreenSky, Inc.

A

Originations, period. That's sort of the beginning and the end of the story. We've grown our home improvement book, $800 million to $1 billion each of the last three years. Our 2018 cohort was the strongest we ever added. We gave you a little color as to the growth we're seeing in elective healthcare. So, we feel very, very good with respect to the origination outlook, but it's much an origination story.

Robert Wildhack
Analyst, Autonomous Research

Q

Got it. Thank you.

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Gerry R. Benjamin
Vice Chairman & Chief Administrative Officer, GreenSky, Inc.
A

Thank you.

Operator: Thank you. And our next question comes from Jason Kupferberg from Bank of America. Your line is open.

Amit Singh
Equity Research Analyst, Bank of America Merrill Lynch
Q

Hi, guys. This is actually Amit Singh. I just wanted to quickly talk about your new product, the revolving credit product. You're in the pilot stage. So, I just wanted to check about the growth that you're seeing over there, and if you could talk about the basic economics of that product, if they differ anything from your other products, and the type of growth that you're expecting for that product in 2019 and beyond, and if that expands your overall end market in any way?

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.
A

Yeah. So, thank you for the question. The economics are the same, number one. Number two, it's actually very exciting, because it's tremendous amount of technology and opportunity that ultimately will have a place, not only in our elective medical business, but it's another very important part of our platform. And so, for us, it's just another important feature functionality and differentiator that can be fully integrated with – that is fully integrated with the rest of our business that will just support growth, as I mentioned, not only in healthcare, but potentially in other verticals. And we think it just makes the market opportunity for us even bigger.

Amit Singh
Equity Research Analyst, Bank of America Merrill Lynch
Q

All right. Perfect. And just one quickly a question on modeling part, below the adjusted EBITDA, any differences, let's say, from 2018 into 2019 that we should see and, let's say, interest expense, D&A and all that?

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.
A

Gerry, Rob?

Robert G. Partlow
Chief Financial Officer & Executive Vice President, GreenSky, Inc.
A

Yes. No, I mean you would expect certainly early interest expense based off of higher funding costs. We expect LIBOR to be pretty much consistent, up slightly for the rest of the year. So, that would be one item I would base that more on fourth quarter with a slight uptick. Other than that, other [indiscernible] (00:54:13) adjustments piece, a little bit more in the way of equity based comp, but just marginal increases there. Happy to go through more detail on that, but it's pretty consistent.

Amit Singh
Equity Research Analyst, Bank of America Merrill Lynch
Q

All right. Thank you.

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Rebecca Gardy
Senior Vice President, Investor Relations, GreenSky, Inc.

Operator, I don't see any more questions. Is that correct?

Operator: Yes, ma'am. I'm showing no further questions at this time.

Rebecca Gardy
Senior Vice President, Investor Relations, GreenSky, Inc.

Okay. I think we'll turn it over to David for some quick closing remarks. David?

David Zalik
Chairman & Chief Executive Officer, GreenSky, Inc.

Yes. Thank you. I want to thank everybody for the call. I want to thank the team for getting ready for the call, and we're going to go back to work now.

Rebecca Gardy
Senior Vice President, Investor Relations, GreenSky, Inc.

Thanks.

Gerry R. Benjamin
Vice Chairman & Chief Administrative Officer, GreenSky, Inc.

Have a great day.

Rebecca Gardy
Senior Vice President, Investor Relations, GreenSky, Inc.

Thank you.

Robert G. Partlow
Chief Financial Officer & Executive Vice President, GreenSky, Inc.

Thank you.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone, have a wonderful day.

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