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GreenSky, Inc. (GSKY)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the GreenSky Second Quarter 2019 Earnings Conference Call. At this time, all participants are listen-only mode. Later, we will conduct a question-and-answer session. Instructions will follow at that time. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to turn the conference over to your host, Rebecca Gardy, Senior Vice President-Investor Relations. You may begin.

Rebecca Gardy

Senior Vice President, Investor Relations, GreenSky, Inc.

Thank you, Nicole, and good morning, everyone. Early this morning, GreenSky issued a press release announcing results for its second quarter ended June 30, 2019. You can access this press release on the Investor Relations section 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 Robert 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 risks and uncertainties that could cause actual results to differ materially from those projected. We disclaim any obligation to update any forward-looking statements, except as required by law. Information about these risks and uncertainties is 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 counterparts in the presentation materials, the press release dated August 6, 2019, and on the Investor Relations page of our website.

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

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

David Zalik

Chairman & Chief Executive Officer, GreenSky, Inc.

Thank you, Rebecca. Good morning, everyone and thank you for joining us. I'd like to start off this morning by providing a brief overview of our Q2 2019 performance. You will see on slide 3 that we reported transaction volume of $1.6 billion, reflecting a 20% year-over-year growth. From a volume perspective, second quarter started with a strong April performance; however, May and June were weaker than expected. While we continue to observe solid demand in our core home improvement and elective healthcare verticals, our newer verticals are taking a little longer to ramp than anticipated. The combined specialty retail/e-commerce vertical represents a huge addressable market, and I remain convinced that our large ticket prime, super-prime credit focus will bear fruit.

Of note, I was very pleased to see that both our core home improvement and elective healthcare originations for the month of July were strong, up 21% and 43%, respectively, versus a year ago. On a company-wide basis, notwithstanding a bit of slower ramp of specialty retail [indiscernible] (00:03:45) for our new verticals, we continue to fully expect that calendar year 2019 transaction volume will be up more than 20%.

GreenSky reported second quarter adjusted EBITDA of $52.9 million, representing an adjusted EBITDA margin of 38%, which demonstrates our business model's profitability as well as strong cash flows. While the quarter was a bit choppy with a few moving pieces, GreenSky continued to generate significant free cash flow. Liquidity remained strong with unrestricted cash of $209 million at June 30 after repurchasing $146 million of our common stock over the past eight months, pursuant to our board-authorized $150 million share buyback program. Moreover, the net debt of less than 1.5 times adjusted EBITDA, the company supports very modest financial leverage.

Since GreenSky consummated its May 2018 IPO, the company has added additional team members to our senior operating team and invested significantly in infrastructure and technology. I believe the company is well-positioned to introduce exciting new products, tools, and services that will allow us to both enter new markets and to continue to penetrate our existing core markets for years to come.

As referenced in this morning's press release, the GreenSky board, in consultation with its financial and legal advisors, has commenced a review of strategic alternatives. Given the company's attractive asset-light business model and historic track record of strong and stable cash flow generation, we believe that the company's current market value does not reflect the company's intrinsic value. With annual volume growth in excess of 20%, EBITDA margins of 38%-plus, and operating cash flow that has materially exceeded reported adjusted EBITDA on a consistent basis, we believe that this review is an appropriate next step as we look to maximize shareholder value.

I'll now turn it over to Gerry.

Gerald R. Benjamin

Chief Administrative Officer & Vice Chairman, GreenSky, Inc.

Thank you, David, and good morning. The company's transaction fee rate of 6.9% for the second quarter was up slightly from last year 6.8% due predominantly to mix shift. You'll see on slide 4 that as of June 30th we had 16,603 active merchants on our platform, an increase of 24% compared to last year. Since the company's inception through the end of the second quarter, GreenSky has now enabled over $19 billion of transactions with over 2.6 million consumers.

Our total aggregate bank commitments on slide 6 was $11.9 billion as of the end of the second quarter, with $4 billion of which unused. In an effort to potentially complement the company's traditional bank funding model, GreenSky has been exploring the merits of entering into a forward flow arrangement with one or more insurance companies, institutional asset managers, or governor-sponsored pension plans. Preliminary expressions of interest received, along with indicative pricing, suggests that such funding sources have the capacity to material augment GreenSky's existing bank funding commitments.

Of note, such forward flow arrangements would likely take the form of a whole loan sale by a partner bank originator whereby the company's traditional bank waterfall arrangement would be complemented by a complete risk transfer, resulting in materially less post-origination finance charge reversal and credit performance related earnings volatility to GreenSky.

Slides 7 and 8 reflect the average FICO score origination of consumers which remains exceptionally strong at 769. Consumers with average FICO scores of 780 or above comprised 37% of the loan servicing portfolio at June 30th. And notably over 85% of the FICOs had scores of over 700. 30-day delinquencies for the second quarter were up to 1.31%, up 27 basis points compared to an unusually low 1.04%, partially attributable to the percentage of growth in our Patient Solutions book and reflecting the continuing aging of the GreenSky loan servicing portfolio.

On slide 9, we disclosed our Origination Productivity Index, or OPI, which was 21.3% in the second quarter, down modestly from 21.9% in Q1 and 22.3% in the second quarter of 2018. In partnership with American Express, we anticipate marketing of the Amex direct-to-consumer home improvement loan powered by GreenSky to commence prior to month-end in the five select markets previously disclosed. While it will certainly take a few quarters before we're able to evaluate early results, we look forward to keeping you informed as to the progress of this exciting American Express direct-to-consumer collaboration.

Finally, the GreenSky's board's pending evaluation of strategic alternatives and management's exploration of complementing the company's current bank funding model with one or more forward flow risk transfer arrangements resulting in reduced post-origination earnings volatility leads us to suspend guidance until we can provide greater clarity for the longer-term.

And with that, I'll turn it over to Rob to review the company's financial performance for the quarter just ended. Rob?

Robert G. Partlow

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

Thank you, Gerry. As I review the results of the second quarter during my remarks, note that all comparisons will be relative to the second quarter of 2018, unless otherwise stated.

Transaction volume increased 20% to a record $1.6 billion in the second quarter of 2019. Excluding solar originations which were approximately $24 million lower than last year, we grew transaction volume by 23% during the second quarter. While April's transaction volume was up by healthy 27% over the prior year, we did experience a weaker than expected growth rate in June. However, we have seen transaction activity rebound in July to a monthly record of $562 million. While the elective healthcare business continues to grow according to plan during the quarter and represent a 9% of the platform's originations, we did experience a delay in the rollout of several of our specialty retail and e-commerce product initiatives.

Total revenue grew 31% to $138.7 million in the second quarter, fueled by 20% growth in transaction fees, which totaled $108 million during the quarter. The average transaction fee for the second quarter was 6.87%, 3 basis points higher than last year's 6.84%. As always, seasonal fluctuations and the mix of different promotional products offered by our merchants and our providers will cause our transaction fee percentage to ebb and flow throughout the year.

Servicing and other revenue totaled $30.3 million, reflecting both the 31% growth of our $8.2 billion loan servicing portfolio, as well as the recognition of $9 million servicing assets in connection with the modification of one of our servicing arrangements as we look to shift more of our cash flows to more stable fixed servicing fee arrangements. Cost of revenue totaled $56.2 million during the quarter. We break out on slide 11 the components of cost of revenue into three distinct components: servicing costs, origination costs, and the fair value change in the FCR liability.

Origination-related expenses totaled $7.1 million, 45 basis points of originations which is consistent with last year. Servicing related expenses totaled $10.3 million, or approximately 52 basis points of the average loan servicing portfolio, down 6 basis points from last year's 58 basis points, as we continue to benefit from the building scale in our operations. The fair value change in the FCR liability was $38.8 million, or an annualized 2% of the average loan servicing portfolio. The increase of $19.6 million versus last year is a function of both the growth in the deferred interest loan products as a percentage of originations, as well as the increase in bank portfolio yield which negatively impacted receipts.

On slide 12, we have provided the detail of components of the fair value change in FCR liability; and on slide 13, we also break out the fair value change in the FCR liability by the drivers of this expense line. I'll begin with the expense for future finance charge reversals, which is the expense related to the building up of liability on our balance sheet for future finance charge reversals. This expense was $77.7 million for an FCR rate of 3.94%, up from $53.0 million during the second quarter of 2018, or an FCR rate of 3.57%. The increases in expense is due both to the growth of deferred interest loans in the portfolio, as well as the higher APR on deferred interest loans originated since mid-2018.

As previously noted, the FCR rate has increased due to the impact of the higher APRs on transactions and the higher mix of deferred interest loans in our elective healthcare vertical. Receipts from our servicing portfolio reduced the expense for future finance charge reversals and totaled $38.9 million, up 15% over Q2 2018's $33.7 million, as well as up 21% from the first quarter's $32.1 million.

Receipts as a percentage of the average loan servicing portfolio were 1.98% during the second quarter and were up 20 basis points from the first quarter's 1.72%. They were 30 basis points below the second quarter 2018's 2.2%. Contributing to the year-over-year variance was a 56-basis-point increase in bank margin costs, which are now trending down to the prevailing reduction in overall interest rates.

Finance charges and fees were up approximately 77 basis points, while charge-offs net of recoveries were up approximately 51 basis points; in part due to the maturation of the home improvement portfolio, and in part due to naturally higher marginal losses from higher yield products and, as expected, our early testing activities in elective healthcare vertical.

Compensation expenses totaled $20.4 million in the second quarter, an increase of $4.9 million, or 31%, over last year. The increase is driven by $1.4 million increase in equity based noncash compensation expenses. In addition, it included $1.1 million growth in our sales and marketing departments, $0.5 million growth in our IT compensation, $0.5 million growth in our risk and analytics, and $400,000 in severance, coupled with a $900,000 increase in corporate executive compensation as we have expanded our management team and finance teams consistent with becoming a public company.

Property, office, and technology expenditures totaled $4.5 million, or up $1.4 million from Q2 2018, driven by a $1.2 million increase in our software, hardware, hosting, and communications spend. General and administrative expenses totaled $7.5 million during the quarter, up $3.4 million driven primarily by $700,000 to higher legal spend, $900,000 of higher insurance cost, and various items.

Other expense increased $7.3 million, primarily due to a $6.4 million re-measurement of our tax receivable agreement liability due to new state tax rates in effect for 2019. There is a corresponding $7.5 million benefit from the re-measurement of our deferred tax asset included within our income tax line item. Operating profit was $46.5 million for the second quarter, in line with last year's operating profit. From a GAAP perspective, we had a second quarter tax benefit of $4.4 million, driven primarily by the aforementioned re-measurement of our deferred tax assets.

Net income was $39.2 million in the quarter. Because GAAP net income excludes noncontrolling interest, a function of our Up-C structure, we believe pro forma net income is a useful measure of our enterprise financial results. Pro forma net income was $33.6 million, using 19.25% as an effective tax rate, and is up marginally from Q2 2018's $33.5 million.

As we've indicated on prior earnings calls, we believe that adjusted EBITDA is one of the key financial indicators of our business performance over the long-term, and provides useful information regarding whether cash provided by operating activities is sufficient to maintain and grow our business. For the second quarter, adjusted EBITDA was $52.9 million compared to $51.9 million last year.

Turning to our balance sheet, we finished this quarter with $209 million of unrestricted cash. Free cash flow for the six months of 2019 was $37.5 million, as detailed on slide 17. In June 2019, we entered into a $350 million notional four-your interest rate swap agreement that effectively modified our exposure to interest rate risk by converting interest payments on a portion of our variable rate term loan to a fixed rate basis, thus reducing the impact of interest rate changes on future interest expense. The hedge is classified as a cash flow hedge for accounting purposes.

During the second quarter, we repurchased $4.5 million additional shares of Class A common stock at a cost of $51.3 million, under our $150 million board-approved share repurchase program. Since announcing the share repurchase program, the company has repurchased 13.4 million shares of its Class A common stock at a cost of $146.1 million. We have concluded repurchases under the 2018 board-authorized share buyback program.

And with that, I will turn it over to Rebecca for the Q&A.

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

Thank you, Rob. That concludes our prepared remarks. Please remember we're happy to take details, modeling questions offline. And with that, operator, let's please have our first question.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from James Faucette from Morgan Stanley. Your line is now open.

Steven M. Wald
Analyst, Morgan Stanley & Co. LLC

Q

Hey. Good morning. It's Steven Wald on for James. Just a quick one on the two announcements, the strategic alternative and the guidance. Just wondering how those play into each other and why use the decision to explore the strategic alternative to then also suspend the guidance and why those two are related?

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

A

I'm happy to take that question. The decision to explore the strategic alternatives was one that the board felt was timely and appropriate for the benefit of all shareholders. As I said in my prepared remarks, we're also exploring augmenting our existing bank partnership arrangements with various risk transfer mechanisms that would allow us to limit the volatility post origination of our earnings stream; both the FCR would go away with the sale of whole loans in a sort of flow basis, as well as any volatility associated with credit.

So as we work through that augmentation of our capital structure and funding model, it will have an impact on our modeling. We are confident that the folks will give us time to get through this strategic alternatives review, as well as evaluate the results of augmenting our funding model. So we'll be able to give guidance that is comprehensive in nature.

Steven M. Wald
Analyst, Morgan Stanley & Co. LLC

Q

All right. Fair enough. And then just maybe one quick follow-up here. On the announced potential non-bank partnerships, I know you mentioned you're working through the potential risk transfer and what that would look like. But just conceptually how would that interact with your current round-robin structure with the bank partners and how that would fit into it?

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

A

Sure. David, do you want to take that?

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

A

Yeah. So we have a robust bank network that we see growing. We are exploring, as we've discussed, augmenting that with insurance company funding and long-term forward flow arrangements. It would just be part of the round-robin. The structure would be different in that there would be no waterfall. Those participants would fund loans at a premium or a discount, pay in the form of fee, and then there would be no future asset reliability, but it would just augment our existing round-robin.

There's also the parent interest from some of our existing partners to explore different structures that would allow for simpler accounting and more transparency, and as Gerry mentioned, complete risk transfer.

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

A

I think it [ph] would – just (00:21:35) another player in the round-robin actually.

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

A

That's correct.

Steven M. Wald
Analyst, Morgan Stanley & Co. LLC

Q

All right. Great. Thanks.

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

A

Thank you.

Operator: Thank you. And our next question come from John Davis from Raymond James. Your line is now open.

John Davis
Analyst, Raymond James & Associates, Inc.

Q

Hey. Good morning, guys. I really just want to hit on the decision to explore strategic alternatives really quickly on the heels of going public. Was this something that you guys contemplated selling the business before you went public? And then also any kind of timeline on the review. And are there any – besides going private or selling yourselves, any other strategic alternatives that you would consider?

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

A

Hey, good morning. Thanks for the question, John. Clearly, their company had a number of alternatives that it evaluated prior to going public. That was one of many that the board looked at. The company has had strong access to capital historically. I think folks recognize that GreenSky has an unusually potent business model and produces strong free cash flows. We don't know what the outcome of that strategic review will be. I think the board is going to be comprehensive in its review. Obviously, there's outstanding alignment with the shareholders, the public shareholders, and we're looking exclusively to optimize the value for all constituencies. Don't have a defined time, but I think the board is going to be deliberate in their approach, and we'll be communicating once we have something to communicate. That's probably the best I can say right now.

John Davis
Analyst, Raymond James & Associates, Inc.
Q

Okay. And then just on transaction volume, obviously, David, I think, you touched on the deceleration in April – or, sorry, in May and June; but did say you still expect 20% for the full year. Maybe talk a little bit more about what was the deceleration, what drove that? I know you mentioned specialty retail, but kind of what gives you confidence in rebounding to the rate that's going to get you to 20% for the full year?

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

So, I think, May and June, there was some headwind or less growth than we expected in home improvement, but the confidence comes from the fact that July was so much better than expected. So we're not sure what was the distraction in the market for May and June, but July was very, very strong. And so, as long as there's no material disruptions in the market for the rest of the year, we feel really good.

John Davis
Analyst, Raymond James & Associates, Inc.
Q

Okay. And then last one from me. Just, I want to talk about the funding cost of the potential new channels relative to the bank channel. It sounds like – just want to make sure I understand this, right – you're potentially shifting more risk to the other partner, which I would assume would come with a lower yield but less volatility for GreenSky. Is that the right way to think about these new potential partners on the funding side?

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

Correct.

John Davis
Analyst, Raymond James & Associates, Inc.
Q

Okay. All right. Thanks, guys.

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

Reginald Lawrence Smith
Analyst, JPMorgan Securities LLC
Q

Hey. Good morning, guys. This is Reggie actually, calling in for Tien-Tsin. I guess a quick question, trying to get clarity here. So, with this new potential funding model, and I can appreciate how it can impact profitability going forward; I guess, the question is, would this replace the entire existing book? And the reason I ask is that, guidance and profitability for this year is really going to be driven by the book that you have now. And so, unless you're changing the terms of the existing book, you should have pretty good visibility into profitability for the reminder of the year. So what am I missing there between the new funding model and why you're pulling guidance?

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

A

Got it. So, I think, fundamentally, it does not work the way that you described. Other than that, we're on the same page. So first of all, the new funding options would augment our existing structure; it would not replace it, it would build upon it, while the existing network we expect to continue to grow. And in that new structure, some of our new originations would take the flavor of a premium or a discount, and that premium or a discount in current period would have a immediate effect. It would create completely different accounting than the waterfall structure.

So, you're absolutely right that the back book will continue to be the back book, but new originations, the next billions of dollars that we originate this year alone could be some of that in a different structure that would have completely different accounting.

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

A

So, Reggie, basically we would book our transaction fee as we do today. To David's point, we'd have a closed transaction whether it be either a premium or a discount paid by the counterparty in exchange for receiving full risk on the performance of that loan. The FCR as we know it today would not be applicable to that loan, that's now on someone's balance sheet, nor would an incentive fee opportunity. So you would have a matching, if you will, of your transaction fee in your economics at the time that we facilitate the transaction, contrasted with our bank waterfall model today where we share an incentive fees over the life of the loan.

Reginald Lawrence Smith
Analyst, JPMorgan Securities LLC

Q

Got it. So, I guess, in theory, this transaction fees or transaction revenue rate could possibly go down, but the FCR [ph] stuff of a notional perspective (00:27:32) shouldn't necessarily change because it's based on the legacy book. [ph] Yes, no? (00:27:39)

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

A

No, recall, the transaction fee is paid by the merchant. This would have no impact whatsoever on the transaction fee, but there would be a premium or a discount realized when we close the transaction, that would be in place of the FCR liability and/or performance fee realized today under our bank waterfall arrangement.

Reginald Lawrence Smith
Analyst, JPMorgan Securities LLC

Q

Got it. Okay. Thank you.

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

A

So there's no deferred activity if you will.

Reginald Lawrence Smith
Analyst, JPMorgan Securities LLC

Q

Understood.

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

A

Thank you.

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

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

Q

Hey, good morning. Thanks for taking my questions. Wanted to ask another one on the potential for a forward flow arrangement, because you mentioned insurance companies, asset managers, pension funds. I'm just wondering would this be something that sort of phases in over time, sort of like your bank partners have been added over time and – whatever, I know this is all hypothetical at this point – or would it be a, all three kind of coming on as one big block or potentially block? Basically, I'm just wondering if it's a step function or something that will evolve over time is how we should think about the model?

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

A

Great question. Chris, you mentioned three. What were the three? I understand the bank model and I understand insurance. What was the third?

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

Q

Oh, so I thought that in Gerry's comments, and I was scribbling, so I thought he said potentially flow arrangements with insurance companies, asset managers, and pension funds, but maybe I...

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

A

Yeah, you heard it correctly.

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

A

Yeah. Okay. Got it. Got it. Got it. So the short answer is we don't know. Certainly, it's going to be phased in and augment our existing network. For us, the objective is grow the business for the long term, expand our verticals, deepen the penetration of verticals, and the key for that has always been funding. We've been growing our bank partner network. We've known that insurance is a great opportunity. We expect that to be layered in over time, and it has all kinds of benefits related to, I think, particularly as a public company, the simplicity of recognizing revenue associated with the transaction fee and then recognizing either a premium or a discount associated with that particular loan. And then from a forecasting and modeling standpoint going forward, there is no FCR, there is no portfolio dynamic, there is no getting paid more if credit outperforms or getting paid less of credit underperforms; the only thing on the tail would then be just a very predictable servicing payment.

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

A

In terms of structure, what we do expect is a counterparty would write a multi-year arrangement whereby we would agree on a forward flow, we would fund up to an annual dollar amount and those commitments would be sort of billions of magnitudes. And this would sit side by side with our existing bank partners. So just think of it as another peg in our round-robin. But there appears to be quite a bit of appetite and liquidity in the market that would embrace this quality of consumer loan.

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

Okay. And then looking just back at the bank partners, just want to make sure I'm clear on this one. Has anything changed in terms of how they look at the loans driven more from the seasonal accounting standard, the current estimate of credit losses, or is there any – is there nothing new there?

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

Nothing new from our perspective. We continue to have good relationship and good dialogue with our bank network, and we feel very good about it. And certainly if our bank partners want to explore the premium discount approach, we're happy to have that conversation, but we're going to certainly continue supporting them with the waterfall model. So, I would expect that this would transition over time, and we're going to stay focused on what's best for our bank partners, and the insurance partners, our merchants, and our customers.

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

Got it. Okay. Thanks very much.

Operator: Thank you. And our next question comes from Jim Schneider from Goldman Sachs. Your line is now open.

James Schneider
Analyst, Goldman Sachs & Co. LLC
Q

Good morning, and thanks for taking my question. I was wondering if you can provide a little bit more color on kind of the current quarter and 2019 with respect to the sort of noncore and specialty retail verticals. Can you maybe just give us a little bit of a sense as to how much of those, kind of, specialty retail vertical originations had been factored into your 2019 guidance? And are you essentially saying that that's likely to significantly miss your prior expectation at this point?

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

Yeah. Good morning, James, happy to take that. To David's earlier comment, we expect enterprise-wide origination growth to be north of 20%. We did expect that we would see, I believe, it was roughly $400 million coming out of the noncore businesses, the new initiatives, so that would be specialty retail/e-commerce. And as David indicated, we've reprioritized some of our product issuances in response to some really exciting utilities we have in the home improvement space, and we've been a little bit slower to get out some of the utilities to integrate with shopping carts that allow us to capture as much of that specialty retail and e-commerce. So that's where the softness will be.

We feel very, very good about the core home improvement business, we feel very good about the growth we're seeing in the elective healthcare business, but we clearly will come up short on that e-commerce/specialty retailing piece.

James Schneider
Analyst, Goldman Sachs & Co. LLC

Q

That's helpful. Thanks. And then maybe just as a follow-up, regarding the strategic alternatives, are there any aspects or potential possibilities that are off the table at this point? And just kind of directionally how do you think about the benefits or detriments of a strategic, kind of, combination versus a financial, kind of, take-private transaction or anything else you can talk about with that regard? Thank you.

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

A

I'll let David expand, but suffice it to say, the board's singularly focused on optimizing value for all shareholders. David may have some additional comments.

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

A

Yeah, that's exactly right. We're going to do what's best for our shareholders, our merchants, our banks, and our partners, and we're certainly not going to take anything off the table.

James Schneider
Analyst, Goldman Sachs & Co. LLC

Q

Thank you very much.

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

A

Thank you.

Operator: Thank you. And our next question comes from Jennifer Dugan from SunTrust. Your line is now open.

Jennifer Dugan
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Good morning. Jennifer on for Andrew Jeffrey. First, wanted to ask about American Express. It sounded like that was part of the reason for suspending guidance, but we did not think that American Express was previously in the guidance. Am I understanding that correctly?

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

A

No, no. Our reference to specialty retail and e-commerce has got nothing to do with our direct-to-consumer initiative that we'll be launching this month with Amex. You're correct, that's never been figured into guidance. So one's got nothing...

Jennifer Dugan
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay.

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

A

...to do with the other.

Jennifer Dugan
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Got it. And then secondly, can you give us some additional color on the mechanics of the $9 million servicing revenue recognition that seemed to, kind of, helped close the gap on earnings this quarter. I just want a little more detail on that.

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

A

Sure. Rob, you want to speak to that.

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

A

Actually, let me just do it at a high level and...

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

A

Sure.

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

A

...we can go deeper if necessary. So in the dynamics of our waterfall, if the transaction fee is higher, the typical build yield is lower in the tail. We have some assets that generate much lower transaction fee, much higher build yield, and we have an arrangement with one or more of our bank partners that should the asset have a much higher build yield, the structure actually creates so much cash flow that we're obligated to take a servicing asset. So, it's basically recognizing the value of the asset originated in a certain period

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Jennifer Dugan
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. Great. Thank you.

Operator: Thank you. [Operator Instructions] And our next question comes from Chris Sakai from Singular Research. Your line is now open.

Christopher J. Sakai
Analyst, Singular Research

Q

Hi. Good morning. Just a question, I want to just to see how your home improvement segment was faring with the slowdown in the housing market?

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

A

So, we generally, historically, for the last $17 billion have not seen a correlation between housing starts and home improvement renovation. I think it's very easy to conflate those two, but we actually have seen opposite correlation where the more difficult it is in communities to build new homes, the more home improvement there has been. We have seen anecdotally less hyper growth in May and June, but a rebound in July. So certainly, we've seen volatility this year, we can certainly hypothecate, (sic) [hypothesize] (00:37:54) is it trade, we've seen some home improvement retailers certainly talk about the difficulty there, but as it relates to housing starts we don't see a direct correlation and sometimes actually causation of higher home improvement renovation.

Just keep in mind, our average customer spends $10,000, consumer customer $10,000 on our platform. And so our typical merchant is a home improvement contractor selling replacement windows, heating and air, kitchen remodeling, flooring.

Christopher J. Sakai
Analyst, Singular Research

Q

Okay. Thanks. And then, one question on – what was the driver in your increase in finance charge reversal liability to $26 million this quarter?

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

A

Hey, Chris. This is Rebecca. We're happy to take the modeling questions offline.

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

A

Yeah. And I'll also...

Christopher J. Sakai
Analyst, Singular Research

Q

Okay.

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

A

...we certainly walked through in the script kind of the components of the FCR and the line items and when you hear the dialogue...

Christopher J. Sakai
Analyst, Singular Research

Q

Okay.

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

A

...I think you'll see the components broken out.

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

A

And happy to work with you offline.

Christopher J. Sakai
Analyst, Singular Research

Q

Okay. All right. Thanks.

Operator: Thank you. And there are no further questions in queue. I would like to turn the conference back to Rebecca Gardy, Senior Vice President-Investor Relations, for any further remarks.

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

Thank you, Nicole. We want to thank everyone for joining us today. Our next quarterly earnings call will be the first week of November. We look forward to speaking with you again then. That concludes our prepared remarks.

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