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GreenSky, Inc. (GSKY)

Q2 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen. Thank you and welcome to the GreenSky Second Quarter Fiscal 2018 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later on, we will conduct a question-and-answer session and instructions will be given at that time. We're 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, Christy and good morning, everyone. This morning, GreenSky issued a press release announcing results for its second quarter ended June 30, 2018. You can access this press release on the Investor Relations section of the GreenSky website. Presenting on today's call will be David Zalik, GreenSky's Chief Executive Officer; Gerry Benjamin, our Chief Administrative Officer and Vice Chairman; and Rob Partlow; our Chief Financial Officer.

We will be making forward-looking statements on our call today, 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 this morning as well as in our filings with regulators.

Also, our commentary today will include certain adjusted financial measures, which are non-GAAP measures. 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. We have provided reconciliations of the non-GAAP financial measures to GAAP financial measures in today's earnings press release available on 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 for your cooperation on this.

With that, I'll turn it over to David.

David Zalik

Chairman & Chief Executive Officer, GreenSky, Inc.

Thanks, Rebecca. Good morning, everyone, and welcome to GreenSky's second quarter earnings call. It is our first call as a public company following our IPO on May 24 and the first quarter in our history with well over $100 million in revenue and over $50 million in adjusted EBITDA. Although we are a new public company, GreenSky's success reflects an incredible commitment by our entire team and a clear focus on delivering an extraordinary user experience to our merchants and their customers.

For those of you that are relatively new to the GreenSky's story, we are an overnight success, 11 years in the making. Our purpose is simple; we power commerce at the point of sale and we do it in a way that helps businesses grow and delight their customers. We have built a strong ecosystem of merchants, consumers, and bank partners that continues to grow stronger with scale. Each of these constituents benefits from access to each other and to our proprietary technology platform, resulting in a virtuous cycle of increasing engagement and value creation.

We enabled merchants to drive more sales by offering their customers promotional financing at the point of sale. We empower consumers to accomplish things that are important to them with a payment experience that is instant, paperless, transparent, mobile, and preserves revolving credit availability. We provide our bank partners with access to our proprietary merchant network, attractive consumers and unique technology enabling them to build a granular national portfolio of super-prime and prime consumer loans with no loan origination or marketing costs.

This quarter, transaction volume increased to $1.3 billion, a growth of 36% over the second quarter last year. Our home improvement business continues to reflect exceptionally strong growth, increasing 26% versus a year ago. Transaction volume in our new elective health care business is continuing to grow at breakneck pace, whereby we expect monthly elective health care transaction volume to exceed 10% of companywide monthly transaction volume by the fourth quarter.

Our loan servicing portfolio or assets under management as of the end of the second quarter was $6.3 billion, an increase of 41% over last year. Of note, the health of our bank partner's portfolios is stronger than ever. The average FICO score of borrowers in the bank's GreenSky portfolio was 768. 30-plus day delinquencies, an important leading indicator of credit losses for our banks, were at the lowest rate they've been since 2016. And on a static pool basis, we continue to see consistent credit performance across our home improvement and elective health care businesses.

Yesterday, we announced that we have entered into a comprehensive partnership with American Express, whereby our companies will be working together in a number of ways. Together, we believe there are many possibilities for delivering innovative digital payment solutions at the point of sale. We couldn't be more thrilled to be partnering with American Express, one of the world's most trusted brands, long respected for best-in-class customer service. I've been a card member since 1993. None of the guidance that our CFO, Rob Partlow, will be providing today, considers activities related to our American Express partnership.

We have both the momentum and opportunity to continue our growth. We have a wonderful recurring revenue business model, the discipline to grow profitably and ample liquidity $8 billion in bank partner commitment, $2.1 billion of which is currently unused to satisfy merchant demand. As previously shared, we anticipate adding two new banks to our funding consortium in the current calendar year and have receive requests from four existing bank partners to materially expand their commitments as well over the next year. I've never been as excited about the future of GreenSky as I am today.

And with that, I'll turn it to Gerry to comment on our additional key operational metrics. Gerry?

Gerry R. Benjamin

Vice Chairman & Chief Administrative Officer, GreenSky, Inc.

Thanks, David. As David noted, GreenSky has a strong recurring revenue model and it is built upon repeat and growing use by merchants. To that end, we finished the quarter with 13,440 active merchants, a 45% increase year-over-year. This quarter, we added several large new merchants including one of the largest national HVAC and plumbing contractors. We won this business due to our superior technology and process, and the innovative credit products we offered them to drive their sales. We expect annual transaction value from this contractor to exceed $75 million.

A large retail and custom manufacturer of premium vinyl windows and doors, with a footprint covering 25 states, we expect annual transaction volume from this new merchant to exceed $50 million. We're also currently piloting with several large multi-site elective health care providers in the dentistry, oral surgery and ambulatory surgery center fields with combined expected annual transaction volumes of approximately $100 million. As of June 30, 2018, our cumulative customer accounts or the aggregate number of consumer accounts approved on our platform since our inception was 1.9 million, an increase over 45% at this time last year. We report this metric as [audio gap] (8:32) of the GreenSky brand.

In addition, the expansive data that we've been collecting from these consumers since our inception very well may be a source of future growth for the company in cross-marketing products, as well as delivering incremental customers to our merchant network. In response to questions received on our road show, beginning this quarter, we are publicly reporting one of our key performance indicators which we internally refer to as Origination Productivity Index or our OPI. This key performance measure captures future net cash flows to be generated related to the subject quarters originations expressed as a percentage of the quarter's dollar origination.

For context, we facilitate a wide variety of loan products originated on behalf of our bank partners each of which is designed to meet or exceed established lifetime profitability thresholds. GreenSky is truly indifferent as to which loan product our enrolled merchants choose to offer their customers in order for them to close more sales and drive their revenues. Specifically, a loan product carrying a greater consumer promotion comes with a higher transaction fee. Conversely, a loan with a lesser consumer promotion yields a more modest transaction fee.

In light of the relatively short life of each of our GreenSky originated loans, on average, approximately 2.5 years, we believe there's no reason to complicate our OPI computation with present value concepts. Accordingly, we compute OPI each quarter by taking a sum of transaction fees received, plus the interest yield to be received on both reduced rate loans and deferred interest rate loans for the period that interest amounts are to be received, multiplied by the dollar-weighted average life of each loan product in years, less an imputed cost of funds based upon the bank cost of funds index or COFI.

Despite variances in loan product mix quarter-to-quarter, OPI for the second quarter was 22.3%, which is up marginally from the second quarter of last year at 22.1% or the prior's quarter of 21.9%. As a further point of reference, OPI was 20.8% in the fourth quarter of 2016, when our transaction fee rate was 7.8%, then reflecting a product mix containing greater residential solar volumes, which carried higher transaction fees.

Thus, the productivity of GreenSky's second quarter loan originations was stable when compared to both the prior quarter, the comparable quarter last year, as well as the fourth quarter of 2016. Levers at GreenSky's disposal to optimize OPI include the transaction fee rate we charge, the loan product APR that are offered, and the length of the loan product promotional periods offered.

OPI computations are contained in the second quarter financial presentation that has been posted on the GreenSky Investor Relations website. We urge you to take a look at this computation.

And now, I'll turn it over to Rob Partlow for a brief review of our second quarter results and our expectations for the full fiscal year. Rob?

Robert G. Partlow

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

Thanks, Gerry. Before I begin, I would like to note that all my remarks will be as compared to the second quarter of 2017, unless otherwise noted. As David indicated at the beginning of the call, we had a strong quarter. Our network of merchants continues to grow and we have sufficient funding capacity from our bank partners to support our growth.

We had strong top-line growth and delivered exceptional operating margins. Revenue grew by 28% over the second quarter last year to $105.7 million. Transaction revenue was $90.2 million, an increase of 26%, and servicing and other revenue was $15.5 million, up 41%. The total cost of revenue was $33.8 million or an annualized 2.3% of our average servicing portfolio, up from $23.2 million and 2.2% of our loan servicing portfolio last year, driven by the continued growth of our portfolio.

Origination related expense was $6 million, which represented 0.5% of total transaction volume, which was down from 0.6% in 2017. Servicing related expenses was $8.6 million or 0.6% of the servicing portfolio on an annualized basis, consistent with the second quarter of 2017. The fair market value change of our finance charge reversal liability was approximately $19.2 million for an annualized 1.3% of our servicing portfolio, which is up from 1.1% during the second quarter of 2017.

And as a refresher, this line item represents GreenSky's obligation to remit previously billed but uncollected finance charges on deferred interest loans that were paid off during the promotional periods. The estimated reversal rate for billed interest on deferred loan products as of June 30, 2018, was 89.7%. For a more detailed FCR roll form that includes receipts and settlements, please refer to the slides we've published alongside our earnings press release this morning.

Operating expenses, which represent total costs and expenses excluding the aforementioned cost of revenue, was $25.1 million, up 15% or $3.2 million from the second quarter of 2017. The largest component of our operating expense is compensation and benefits expense that totaled $15.6 million. 43% of the compensation benefits and expense related to our IT and product teams reflect in our continued heavy investment in our technology platform. Sales and marketing personnel expenses make up the next largest portion of our personnel expenses at 29% of the total and the remaining 28% relates to finance, HR and other support functions.

Our other income and expense was a $4.4 million increase compared to 2017, primarily because of our term loan B debt issuance and refinancing, which occurred subsequent to the second quarter of 2017. As a result of the debt issuance, we focus on our adjusted EBITDA as our primary measure of performance for compatibility purposes. In addition, it reflects the earnings and cash flow generating strength of GreenSky.

Our adjusted EBITDA increased by 28% to $52.1 million from $40.8 million last year. A reconciliation of the adjusted EBITDA is provided in both the press release and the second quarter financial presentation, which are posted on the Investor Relations section at our website. At 49% of revenue, we maintained an attractive profitability margin. Our pro forma net income was $33.5 million or $0.18 per diluted share. This measure includes all of GreenSky's enterprise earnings for the period net of tax expense, which is calculated at our assumed effective tax rate of 22.3% on all of GreenSky's pre-tax earning or income. Because of our up C structure, GAAP net income only reflects the tax expense on the earnings of our Class A shareholders. As pro forma net income assumes that all earnings are subject to corporate taxation, we believe it is a useful measure for comparability purposes irrespective of the percentage of GreenSky owned by the C Corp.

Now, turning now to the key elements of our balance sheet. Our unrestricted cash was $236.6 million at the end of the quarter, $66 million higher than our S-1's pro forma ending cash balance of $170 million, reflecting the cash generated from the second quarter and a $23.8 million reduction in our loans held for sale, which ended the quarter at $43.4 million. Our finance charge reversal liability was $107 million, reflecting a $6.1 million increase over the quarter, consistent with the continued growth of our deferred interest loan originations.

That brings us to our outlook for the full fiscal year, and then we'll open it up for questions. Based on the company's performance through the end of the second quarter and current market conditions, we expect our fiscal 2018 transaction volume to increase between 35% and 41% to between $5.1 billion and $5.3 billion, revenue to increase 34% to 37% to between $433 million and $435 million, adjusted EBITDA to grow between 20% to 25% to a range of $192 million to $199 million, and pro forma net income in the range of $121 million to $125 million or $0.64 to $0.66 per diluted share, assuming an effective tax rate of 22.3% and a weighted average shares outstanding of 189.2 million. Also, we will file our 10-Q on or before Friday, August 10.

And so, with that, I'd like to turn it back over to Rebecca for Q&A.

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

Thank you, Rob. As a reminder, please limit questions to two each, so that we can get everyone in the queue. Thank you for your cooperation on this. Operator, can we have a first question please.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question is from Tien-Tsin Huang with JPMorgan. Your line is open. Please go ahead, Tien.

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

A

Good morning. Tien, can you hear us?

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

I can. Can you hear me? Sorry about that.

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

A

Yeah, we can. Good morning. How are you?

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

I'm well. Congrats on the IPO. Good to be on the call. I want to ask on the Amex partnership. Can you help us frame, David, how impactful this might be and I heard you not assuming anything in your guidance, which is fine. But, just curious as to if we resize the commitment and the potential for the – onto the P&L from this partnership. Thanks.

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

A

I'll leave it off and then I'll turn it over to Gerry. We're obviously very excited about working with American Express, the company that has a brand and a history that we admire and just incredible coverage both with merchants and consumers. This is part of our strategy of building what some call Connected Commerce what we call Connected Commerce, Integrated Commerce, where search, discovery, purchase, payment, is all integrated in a convenient fashion, leveraging data for consumers. So, we think it is a hugely important opportunity and we're very excited about it. Gerry can try to fill in some more details.

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

A

Yeah. The alliance really consists of three discrete pieces. American Express will be offering the GreenSky technology platform to their cadre of merchants. By way of comparison, we announced this morning that we've got 13,000 active merchants. Obviously, American Express has millions of dyspeptic merchants. Virtually, everyone we aspire to do business with accepts American Express. So, it is a forced amplifier and should provide us operating leverage in touching more merchants.

On the direct-to-consumer side, we're really excited to be offering a co-branded installment loan product that American Express is going to be make available to select American Express card members in five pilot cities. As David mentioned, we've not factored any of the volume or productivity of this alliance in our forward-looking numbers, but the opportunity to expand beyond the pilot has us excited and needless to say, we hope that this will just be the beginning.

Amex will be funding a 100% of those loans in the direct-to-consumer product that they're going to be offering to their card members with technology that will integrate the GreenSky offering into the Amex portal, which we're all excited about. And then, lastly, GreenSky is obtaining access to the American Express vPayment system, which is a token payment methodology that provides great security and we'll think that will be a great additional arsenal in our quiver.

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

A

We're very pleased to leverage what is really excellent technology that American Express has available. And what I would add or underscore is the ability for GreenSky to bring American Express card members to our merchant network has incredible potential for value creation to support our existing ecosystem, you can imagine the competitive advantages that creates for our platform.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

Got it. That's helpful. Just so my second question and maybe I'll ask on the transaction fee rate. It looks like that ticked down a little bit sequentially. Any unusual items in there and maybe can you give us a sense of what that rate might look like in the third quarter and in the fourth quarter? Thanks.

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

A

Yeah. So, that's mix shift, it doesn't impact profitability as our economics are derived by a combination of transaction fee and the performance fee that banks pay us over time. So, nothing unusual. We certainly see it stable as we've torn apart the pieces and feel good about where it is.

We've been growing in HVAC. For example, we're heavily underpenetrated everywhere, but uniquely underpenetrated in HVAC and that particular business will pay us slightly lower average transaction fee. However, the lifetime profit is actually very good and I would refer back to our OPI index, where what we've tried to do, Tien, is calculate the productivity of our originations by taking into account the transaction fee, the performance fee and creating that index. And we were actually very pleased to see that quarter over quarter over quarter, it's incredibly stable.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

Okay. Got it. Thanks for that. Thanks.

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

A

Thank you.

Operator: Thank you. Our next question is from Jim Schneider with Goldman Sachs. Your line is open.

James Schneider
Analyst, Goldman Sachs & Co. LLC

Q

Good morning. Thanks for taking my question. I was wondering if you can maybe talk a little bit more about the Amex partnership as it relates to the direct-to-consumer product? Maybe, give us a little bit of color on what kind of loans you are targeting with that product. Specifically, how it's differentiated from your traditional kind of merchant-facing product and maybe any color on how well – so you think that could be over time and how complementary to the existing portfolio?

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

A

Jim, thank you. I missed your second to last question. Could you repeat the second to last sentence that you just gave?

James Schneider
Analyst, Goldman Sachs & Co. LLC

Q

Just in terms of how – in what ways that is complimentary or differentiated to your existing merchant offerings and how you kind of see it being fitting in with rest of your portfolio over time, direct-to-consumer?

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

A

Got it. Great question. I'd be delighted to speak to that. So, as you know, our core business is providing businesses, merchants in various industries, verticals, a tool, a platform that allows them, the merchant, to offer instant promotional credit to drive revenue, incremental revenue and delight their customers.

And if you go back to the S-1, you may see a diagram of a triangle, and you've got merchant consumer bank as each point on the triangle. What we're doing is, keeping the triangle, but changing the order. More specifically, by patterning with American Express and others, TBD, we're introducing to the consumer, if you're interested in home improvement or a home improvement loan, it here it is, it's available, it's digital, it's instant. You probably already been preapproved by American Express, and oh, by the way, you're in Poughkeepsie and we can tell you the three best contractors in that market. And not only you get a great home improvement loan, but if you buy it from them, you may qualify for 18 months no interest.

So, we're helping consumers do things that are really important and in fact, the real value-add when you want to buy windows or a roof or a flooring is who do you buy it from, how much should you pay? And how do I know that I'm working with someone reputable? Well, GreenSky has data on every merchant we work with and the satisfaction of every customer, consumer customer that we and they work with. So we're able to leverage that data, it's great for the consumer and it's great for the great merchants and the ones that aren't good wouldn't be on our platform anyway. So, this is a value proposition that we're delivering because of our network, because of our technology, that's great for Amex and Amex card members.

It's great for the card member homeowner that wants a home improvement. We can help facilitate the transaction and even perhaps more importantly help them identify and ultimately even schedule an appointment from their mobile device. And this is going back to the integration of commerce and payment that we've been talking about. And this is one step in that direction. The fundamental loan product is the same loan product as what we've originated $13 billion of. The difference is the order of the relationship. Instead of merchant consumer bank, it's actually bank consumer merchant, but the ecosystem is the same, the value prop is actually even greater. And here, GreenSky would be in a position to bring incremental customers to our merchants which actually is not only a value-added proposition for our merchants, but another revenue opportunity where the merchants would be delighted to pay for that incremental revenue versus paying Google which is what they do today.

James Schneider Q
Analyst, Goldman Sachs & Co. LLC

Very helpful color. Thanks for that. And then, maybe secondly on the credit environment. Thank you for providing those metrics and it looks like, especially on delinquencies – delinquencies actually instead of being stable, actually declined year-over-year, whereas a lot of your peers had increasing delinquencies. So, if you can maybe provide a little bit of color in terms of what you're seeing in the market with respect to credit quality, how much of that, if any, is a function of the mix shift and how much are you seeing kind of like-for-like credit quality improve and what do you see going forward?

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

Thank you. So, we see that focusing on quality originations and quality customers pays off. We feel that for the time being, credit is very stable and we're certainly pleased with the results. Gerry, would you like to add anything?

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

No, we slice and dice the portfolio a lot of different ways geographically, obviously aging. Early indicators are showing as solid as we've seen going back to 2016. We're just not seeing any signs of slippage or cracks. But again, as David indicated, our portfolio is super-prime. So, this is the best of the best and we have not opened the gate or widened the funnel, if you will, to reach for growth by relaxing our credit standards.

James Schneider
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thanks and congratulations.

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

A

Thank you.

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

A

Thanks, Jim.

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

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

Q

Thanks very much. I wanted to ask first about the revenue yield calculation or result. It came in a little bit below where we had modeled, but more importantly, I'm wondering, can you talk about the key factors that move yield around and how that yield varied from your expectation – or what your expectations were coming into the quarter?

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

A

James, thank you for the question. When you say revenue yield, are you referring to take rate?

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

Q

Yes. Yeah, I'm sorry.

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

A

So, as the company grows, particularly as we have de-volumed in solar, the average transaction fee or take rate has gotten to a stable place. And just want to emphasize that GreenSky's profitability is based on the sum of transaction fee and performance fee paid by the banks. And just to underscore, if a merchant pays a 9% transaction fee, the lifetime profitability for GreenSky is the same as for the product where a merchant pays 6%. Let me ask Gerry to add some comments I think to your question.

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

A

Yeah, James. The one thing that we are seeing, and David touched on this, the key variable into the take rate will be our mix of business. We have had and are going to continue to have some solid, solid new account additions in the HVAC space in particular. As David mentioned, historically, we've been a bit underpenetrated. These are large national wholesalers doing hundreds of millions of dollars. A lot of these folks had exclusivity arrangements with their prior finance relationship. As they're expiring, candidly, we're having good success in migrating them to the GreenSky platform. It comes with a little bit more modest transaction fee. We love the business. It's year round, it's not episodic.

And obviously, when your air conditioning system or heater goes out, you're going to replace it anytime of year. So, we really like the granularity of the business and it comes a little bit chunky. These are big providers, but that will impact mix just a bit and we have continued to de-emphasize the residential solar business. Obviously, when we talk about that HVAC business, although the transaction fee is a bit more modest, the lifetime profitability is right down the center of the fairway with all our other products.

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

Q

That's great color. Thank you. And then, my second question was, as we look at a bit of a changing interest rate environment, how much friction is there in re-pricing your loan products through your merchants, I guess particularly as interest rates rise?

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

A

So, a great question. You can imagine, it's actually something that we've been very focused on for the last 10 years waiting for rates to rise, predicting rates would rise. So, let me start by, we have been raising rates for over the last year. The rates that I'm referring to are the rates that we charge our merchants. In some categories, we've raised rates three times over the last year and we've been predicting for a decade that merchants want our platform and our product in a high-rate environment and a low-rate environment. Incremental revenue never goes out of style.

We are very pleased that after raising rates over the last year, over a year, and in some cases three times, we have seen that not retard growth. We have seen it not create any kind of attrition. And so, we are pleased that we've been successful in leveraging the three levers that we have to create the same moral equivalent economics for GreenSky between increased transaction fee, APR and promotional life.

So, rates will go up, rates will go down. What we have found is that, that is fine. And the good news is much like the laws of physics, interest rates apply to everybody. So, what consumers perceive in the market changes, sometimes with a little bit of a lag, a couple of quarters. What businesses other opportunities might exist, we are pleased and it's helpful that changes in interest rate affect everyone.

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

Q

That's great. Thank you very much.

Operator: Thank you. Our next question is from Jason Kupferberg with Bank of America. Your line is open.

Jason Kupferberg
Analyst, Bank of America Merrill Lynch

Q

Hey, good morning, guys. Congrats on the results. I just wanted to ask a little bit about the competitive environment. You did mention some, it sounds like some takeaways in the HVAC space, which is interesting. But maybe you can just step through some of the different verticals and sub-verticals and tell us a little bit about what you're seeing on the competitive front right now and anything that you feel has maybe changed year-to-date in that regard.

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

A

So, there's really just nothing to report. We are very fortunate that we're able to go to market with a platform and a value proposition and a technology. And candidly, from a sales standpoint, the biggest challenge is just getting a business owner on the phone and getting them to take the little bit of time it takes to literally live the experience difference. We have not observed any impactful competitive reaction. Our elective health care business is growing incredibly well. The pilots very quickly turned into large commitments, so we couldn't be more pleased. And frankly, what got us here was a heads down maniacal focus on the product and the customer and our partners. And that continues to work really, really well. Gerry, do you have anything you want add from a competitive standpoint?

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

A

No. I would just emphasize, we've not seen really any competitive response to the technology or the deliverable. And we continue to have great success converting betas on the elective health care side and moving big pieces of business that formerly was under exclusivity on the core home improvement side. But I'll reemphasize, as we did on the road show, we know of 155,000 home improvement contractors doing residential work that do more than $1 million in revenue, and of the 13,000 merchants, we work with currently less than 4,000 fall in that category. So, we've got a huge addressable market and we're in the early, early stages of penetration.

Jason Kupferberg
Analyst, Bank of America Merrill Lynch

Q

Okay. Understood. And then, just on the balance sheet, you made a brief reference to the decrease in the loans held for sale and I think that's been the trend the past couple of quarters. Should we expect quarterly volatility in that metric or is there sort of an underlying trend that we should be prepared to see going forward?

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

A

It should stay at very suppressed levels.

Jason Kupferberg
Analyst, Bank of America Merrill Lynch

Q

Okay. Thank you.

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

Andrew Jeffrey
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Hey, good morning, guys. Appreciate you taking the question. I've got a couple for you. I guess for starters, David, I think you mentioned that health care is going to be you think 10% of total volume by the end of the year. Could you elaborate a little bit on the drivers and I'm thinking namely about sponsor relationships and how you're standing up the distribution analogous to that what you've done on home improvement?

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

A

Andrew, thank you for the question. I'm going to turn it over to Gerry, to provide some additional color both between sponsors and the traditional manufacturer distribution sense, but also private equity that had an incredible concentration of control on ownership, but we're also now seeing similar viral effects and referrals and word of mouth, that has been just incredibly encouraging. I'm going to turn it over to Gerry to provide some additional color.

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

A

Yeah. Great question. As we entered the elective health care business, we focused initially on the dental sub-vertical, then moved into aesthetic dentistry and oral surgery. And we're finding that, to David's point, private equity controls a vast and vast amount of the doors in its delivery system. So, with one sales call, one beta, Dennis Kelly, our Elective Healthcare President can showcase the GreenSky's technology, put up a [audio gap] (39:47) and we only need an office or region, a case study and we're able to touch potentially hundreds if not thousands of clinical doors on one sales call.

So, it's a very, very productive sales channel given the private equity concentration and these dental practice management companies or DPMs. Unlike the medical side of the business, these dental practice management companies have achieved high levels of penetration. So, with maybe 40 sales calls, you can touch a big, big piece of the industry, which lends itself to a lot of productivity for us.

Contrast in with our home improvement business, where we've got a large inside sales force that are dialing out to merchants, virtually all of our elective health care sales forces in the field, so we're spending an incredible amount of time identifying stars, interviewing these people, make sure they come to GreenSky with the culture we're looking for, the value system, the ethics and that they're representing us out in the marketplace day-in, day-out. We're being very, very choosy with respect to the sales reps that we add. And we're seeing paybacks that are shockingly quick. We're seeing people hit the door and literally within a month, they're really incredibly productive.

And as David said, we think the lines will cross and I will mention that the growth in elective medicine is mimicking what we saw six years ago in our core home improvement business. So, we do believe that will equal about 10% of monthly originations. So, it's quickly becoming a nice contributor.

Andrew Jeffrey
Analyst, SunTrust Robinson Humphrey, Inc.

Q

That's helpful. Thank you very much. And then, appreciate the OPI. I think that's a helpful way of looking your business. I get a lot of questions about unit economics and mainly the timing of revenue recognition versus expense recognition. Perhaps, you can just talk a little bit about how you think about the transaction fee upfront versus the expenses over the life of a loan and maybe what a unit – what unit level economics look like, especially to the extent that growth slows at any point in time, just trying to kind of flush that out a little bit in my mind?

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

A

Great question. So, from a rev rec, obviously it's consistent with both GAAP, but also I think from our perspective common sense. The transaction fee that we get paid upfront is received in cash up front and it's consistent with the expense that we have to originate and provide the platform. Then, there is a separate revenue stream that is to service the loan. So, they are separate and distinct and I'm going to let – Gerry has got some additional comments.

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

A

Yeah. Once the loan has been originated, really, the ongoing cost would be captured in the servicing line item and our servicing arrangements we believe are at market, where the revenue we receive from our bank partners to service their loans are covering our servicing cost, plus providing a modest margin. So, the ongoing or trailing cost associated with the revenue generation would be the loan servicing component and we've got a fee stream that's covering this.

Andrew Jeffrey
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thanks a lot.

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

Ashwin Shirvaikar
Analyst, Citigroup Global Markets, Inc.

Q

Good morning, folks. Congratulations on your first public report and I appreciate the incremental disclosure. You guys already commented on the impact of mix on the top line, but could you potentially also talk about the impact of evolving mix? As you go down and talk about reversal rates, talk about the different types of loans you're making, is it – is deferred still 40% of the mix, things like that?

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

A

Yeah. So, based on the market, the industries we're in, the industries that we're going into, we expect stability in terms of transaction fee, which I think you referred to as top line. We think that deferred interest is a slightly bigger mix in the elective health care. That actually creates even more resiliency. So, we see stability on the transaction fee side and marginal higher percentage of overall business and the deferred interest product. Ashwin, I don't know if I answered your question or all of them. Did I miss one?

Ashwin Shirvaikar
Analyst, Citigroup Global Markets, Inc.

Q

Well, no, I was asking specifically about the impact of evolving mix as you go down the P&L and look at various lines. I think some of them, we could take a couple of the others offline, but one other question is, really your guidance on transaction revenues does imply an acceleration of transaction volume, potentially a step up in the take rate. How much visibility do you have into that? The rev guide implies that you're going to actually accelerate in the second half and I mean, can you explain that a bit more in granular fashion?

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

A

Yeah. So, we have a lot of visibility in terms of transaction volume, because we see every cohort of merchants how they've performed. We have a lot of history on seasonality. We're about to enter our busy season for the year. The low point of the year is the first quarter and then spring happens. But, it really gets good in the fall. So, we have a lot of history on seasonality. We have a lot of history on, if we know what second quarter is just based on seasonal growth, we know with a lot of historical precision what third and fourth quarter looks like. So, I'm not sure if I'm answering your question, but I'm going to keep at it until I do.

Ashwin Shirvaikar
Analyst, Citigroup Global Markets, Inc.

Q

No. I think seasonality, one component. I was just kind of wondering if you have already layered in some of those HVAC wins into the next sales cycle?

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

A

Yeah. Absolutely. So, let me dig in to just a little bit on how we think about forecasting every vintage of – or cohort of merchants across all of our different business units or categories or subcategories, whether it's home improvement or HVAC as a subcategory, we track how much business do we do with them month on book one, month on book six, month on book nine. And once we know how much business that cohort is doing at month on book four, book five, book six, we can fairly accurately predict how much business are we going to get seasonally for the next three years.

And so, we have a very granular build up. And we do it several different ways and they all triangulate to a very similar number. And so, it's not just, Ashwin, taking June volume and saying, oh, well, every year, November is this percent more than June. It's actually granular taking every cohort of merchants that's active on our platform and plotting out how much business did they do in June, how old are they on our platform, how much business are they likely to do for the next six months? So, it is a very granular build.

Ashwin Shirvaikar
Analyst, Citigroup Global Markets, Inc.

Q

Got it. It's very useful. Thank you.

Operator: Thank you. Our next question is from John Davis with Raymond James. Your line is open.

John Davis
Analyst, Raymond James & Associates, Inc.

Q

Hey, good morning, guys. I just want to touch on the Amex partnership. Any thoughts on timing of rolling this out and who's responsible for making the merchants aware that they now accept GreenSky? Was this was a national campaign? You guys may need to go on from a marketing perspective, but just talk a little bit about that and then maybe how the economics are similar to or different from your other bank relationships?

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

A

So, I think you're – John, thank you for the question. Was your question focused on the American Express promoting the American Express home improvement loan powered by GreenSky that's going to introduce Amex card members to our loan and our merchant network?

John Davis
Analyst, Raymond James & Associates, Inc.

Q

Yeah. I mean – so Amex is responsible for marketing that or is that you guys?

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

A

Correct.

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

Okay. And then, on the economics side, how was it? Is it similar to your other bank relationships, just maybe high level obviously, you can't give specifics, but high level, how should we think about the economics here?

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

So, the simplest direct way to answer that question is, we do not see this relationship negatively impacting gross margin.

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

Fair enough.

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

So, we're obviously very pleased with incredible distribution. This is launching in five markets this fall, early fall and we have actually been working on in parallel to signing these contracts, which literally were just signed the day before yesterday. But we've been working with Amex for a long time on this rollout and planning this and they've just been an incredible partner.

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

Okay. Not to be a dead horse here, but on the transaction yield, my math implies that the guidance would imply a 50 basis point improvement in the back half versus the first half. So, kind of a 7.3% take rate versus the first half, just north of 6.8%. Is that – elective health care, is that comes on. I know you talked about HVAC weighing on one side, but it's my understanding that the majority of elective health care is the 10% upfront deferred interest loan. So, you have a balance there. Is that reasonable?

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

Yeah, you nailed it. You're spot on.

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

Okay. All right. Thanks, guys.

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

Thank you.

Operator: Thank you. Our next question is from Jeff Cantwell with Guggenheim. Your line is open.

Jeff Cantwell
Analyst, Guggenheim Securities LLC

Q

Hi, good morning.

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

A

Good morning, Jeff.

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

A

Good Morning.

Jeff Cantwell
Analyst, Guggenheim Securities LLC

Q

Just one question. You touched on this a little bit earlier, but in terms of your active merchants, can you tell us a little bit more about where the incremental adds came from this quarter? What I'm trying to get a sense of is whether or not the same thing in particular to call out like you're starting to see, for example, a greater amount of incremental merchants coming from elective health care or I guess in other way of looking at is, focused on home improvement. There, maybe you could tell us what you're seeing in terms of which geographies or any routes are coming from, et cetera, anything you could tell us there about would help us understand the underlying trends and active merchandise would be helpful? Thanks.

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

A

Great. So, in home improvement, we're seeing an acceleration of signing up more merchants. We actually have an acceleration of new large home improvement merchants. But frankly, the biggest impact is a rapidly growing elective health care business that was zero a year ago in terms of contribution. And by the end of this year, on a monthly basis, it'll be over 10%, and we are now getting the benefit of having multiple high-growth profitable businesses. That certainly creates a wonderful accelerant. So, nothing that I can think of to point out. We are equal opportunity growth in America. I haven't seen any geographic, anything unique. We love North Dakota. We don't get a lot of incremental business from them, but we haven't seen any unique growth concentration.

Jeff Cantwell
Analyst, Guggenheim Securities LLC

Q

Okay. Thanks very much. And then, in terms of the guidance, on your full-year EBITDA guide, can you help us think through the margins in the back half of the year? I guess, the implied guide is a step down from this quarter and is some of that planned investment? Is that seasonality, Just want to think through the puts and takes as we get comfortable with the business model. Thanks.

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

A

Yeah. We invest on a consistent basis throughout the year. So, we don't have heightened investment, but we do see softening in the fourth quarter. People traditionally don't want home improvement contractors in their home between Thanksgiving and Christmas. So, the business does quiet down materially. Late November and throughout December, it gets very, very quiet. So that's just the seasonal impact. We do have some modicum of fixed cost in the system.

Jeff Cantwell
Analyst, Guggenheim Securities LLC

Q

Thank you very much.

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

A

Sure.

Operator: Thank you. Our next question is from Paul Condra with Credit Suisse. Your line is open.

Paul Condra
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thanks and congrats on the IPO. Thanks for taking my question. Just a follow-up on the margins then, so can you help us think about sort of your mid-term margin expectations increasing flat and what are kind of the key components that determine how you're going to run this business from a margin perspective?

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

A

I think we're all pretty satisfied that we're going to maintain the same margin profile we've been showing. There'll be some seasonal variance quarter-to-quarter, but we've guided to the mid 40s on the EBITDA margin. There's nothing we're seeing that leads us to believe that that isn't sustainable. To the extent that our elective health care business grows at a quicker rate than anticipated, you could see a bias on the upside there, but that would be probably the largest contributor to that EBITDA margin growing above the mid 40s. We're continuing to invest heavily in the infrastructure, the technology. We've got product groups working on both products and applications to serve our existing markets as well as a bunch of new initiatives that we're excited about that hopefully will bear fruit years down the road. But it's a very, very robust pipeline of technology products. So, we've got to keep feeding it with resources.

Paul Condra
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Thanks. And then on the no interest loan mix, can you just remind us what the mix was or tell us I guess what the mix was in the quarter and any change in your ability to kind of manage that mix the way it is or any reason to think that should change over time?

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

A

So, in the quarter, it was roughly 34% and we generally expect it to stay in that range. It will go up a little bit as health care continues to grow.

Paul Condra
Analyst, Credit Suisse Securities (USA) LLC

Q

34% no interest.

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

A

Deferred interest.

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

A

Deferred interest.

Paul Condra
Analyst, Credit Suisse Securities (USA) LLC

Q

It was deferred. Okay, got you. All right. Yeah. The repayment rates on those or the payment, the percent of the mix you pay down within the deferral period?

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

A

Yeah, that's highly stable, 90%.

Paul Condra
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thank you.

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

A

Thank you.

Operator: Thank you. [Operator Instructions] Our next question is from Chris Donat with Sandler O'Neill. Your line is open.

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

Q

Good morning. Thanks for taking my questions. I had one follow-up on the health care business. As you're looking at the rapid growth you have and I think may best directed at Gerry. Do you have any goal for the number of salespeople you want to have in the field? And if so, can you give us a rough sense of what percentage or qualitatively where you are in the hiring process for that sales force?

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

A

Yeah, great question. We've got in the mid teens in terms of number decentralized sales folks. We also have a group of account managers that work to support the businesses and the practices and we're growing those in sort of stepwise fashion. We've learned how many account growth managers we need to support providers. So, we're constantly recruiting the sales talent. We're being particularly finicky over, these are outside salespeople, they are representing the company in the field. So, we're spending a lot of time interviewing each and every one with senior executives of the management team interfacing, to making sure that we're really careful not to make any mistakes.

And this is a little bit different than our home improvement business where we had greater control, because it was launched largely with an inside sales infrastructure, where you could have centralized control and QC. When you have a bunch of people out in the field, we don't want people taking shortcuts and selling ways that we wouldn't be pleased with, so we're being very, very careful.

So, the pipeline is full. We're accelerating the pipeline, because we're seeing tremendous payback and quick productivity, but we're balancing that acceleration with not taking shortcuts in terms of the quality of the applicant that we're seeing. I wouldn't be surprised if the count increases 50% over the next 12 months, however.

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

Q

Okay. Thanks for that one. And then, just on the credit quality for the bank partners. You mentioned that delinquency rate is lowest since 2016. I assume there's been no change in underwriting FICO scores, anything like that. So, is your theory that the economy is better, the job market is better or has there been some change in what you're originating? Just trying to understand why it's good. I think it's a pretty good economy, but would like your take.

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

A

Yeah. Well, I think the bigger point is, we have not chased volume by sacrificing credit quality for our bank partners. These are our bank partners' loans, it's their credit policy and we work with them to optimize both durability, resiliency and volume. And I'd say that our bank partners have done a great job and we're really happy to support them in doing that. And we've all, I think, acted with a great of discipline and long-term thinking.

Operator: Thank you. Our next question is from Michael Tarkan with Compass Point. Your line is open.

Michael Matthew Tarkan
Analyst, Compass Point Research & Trading LLC

Q

Thanks for taking my question. Just to follow-up on that last one. Can you just give us a little color as to where losses on the product are currently trending and maybe what yields banks are currently receiving?

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

A

Yeah. With respect to our contracted bank yields, we view that as competitive in nature. We don't disclose that and we don't see that changing over time. You'll note in our OPI computation, one of the reasons we use the copy index is we wanted to use a published index that's available for people to as a surrogate for bank cost of funds, but we view that as competitive. So, we will not be disclosing that. With respect to losses on a static pool basis, I think David mentioned in his opening remarks, credit quality has been incredibly resilient and consistent. We're just not seeing any breakage at all or any signs of weakness.

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

A

Yeah. One thing I want to underscore before we wrap up. Our bank partner ecosystem is obviously incredibly important to GreenSky and we're very pleased that not only do we continue to expect to announce two more large commitments this calendar year, but four of our largest banks have indicated an interest, one increasing their commitment by a $1 billion, another an increase by $1.5 billion, another one an increase of $750 million and the last one, an increase of $1 billion.

So, said simply, we have a tremendous amount of demand and we're actually having very constructive conversations managing down the hope and ambition and expectation, but also engaging in really, interesting conversations about creating of additional products that are strategic with and for our bank partners. So, I just wanted to underscore that. Turn it over to Rebecca.

Rebecca Gardy

Senior Vice President, Investor Relations, GreenSky, Inc.

I think, operator, that was the last question that we'll have time for today. I wanted to say thank you to everyone. That concludes the Q&A portion of our call. And before I turn it over to David for closing remarks, I did want to announce that we'll be attending the Citi 2018 Global Technology Conference on September 5. The Goldman Sachs FinTech Conference on September 6 and both events will be held in New York. David?

David Zalik

Chairman & Chief Executive Officer, GreenSky, Inc.

Thank you, Rebecca. I'm excited about the future of GreenSky. Our core U.S. home improvement and elective health care addressable markets alone exceed $650 million with a small market share in these two significant industry verticals, notwithstanding the impact of our new collaboration with American Express, we have the ability to grow GreenSky exponentially.

As we demonstrated this quarter, our business model has inherent scale, as we continue to add more merchants to our platform. We reach more consumers, and we facilitate more transactions for our bank partners. We have strong recurring revenue with each annual cohort of merchants increasing their volume on our platform. Our cost of merchant acquisition is on the low-single digits and our annual dollar-based retention of merchant transaction volume remains above 100%. And most importantly, for our shareholders, we deliver a unique combination of highly attractive operating margins and growth.

With that, thank you all very much for joining us on today's call. We're off to a strong start as a public company. We have significant runway ahead and the teams are aligned on priorities and highly focused on execution. We look forward to seeing many of you in the New York conferences. I'd like to congratulate the GreenSky team on a good start and wish my wife, Helen, a Happy Anniversary. I'll be home late tonight. Thank you very much.

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