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24 February 2023

Earlypay Limited (ASX: EPY)

1H'23 Results, RevRoof & Trading Update

Earlypay ("EPY" or the "Company") today announces its financial results for 1H FY23 (1H'23) and provides an update on its exposure to RevRoof Pty Ltd and Painted Steel Technologies Pty Ltd (together referred to as "RevRoof") and an outlook for the remainder of FY23.

Key Highlights

- An agreement for the sale of the assets of RevRoof Pty Ltd been entered into and EPY is recognising a specific loss provision of $9.6m
- The Company is also recognising a $4.5m ECL provision in addition to RevRoof
- While Reported NPAT was a loss of $4.3m, Proforma NPAT (excluding the impact of RevRoof) was a profit of $1.6m
- EPY is confident this result reflects a low point in earnings with H2'23 and FY24 Underlying NPAT expected to be materially stronger driven by lower provisioning, continued growth in funds in use and margin expansion

1H'23 Reported Results

The reported results for H1'23 are disappointing and were significantly affected by the loss provision for RevRoof (covered in more detail below and in a separate release made today). The key points from the Reported results are as follows:

- Average Funds In Use (FIU) across all products was up 40% on pcp to $343m, however the inability to offset higher interest resulted in a 3% decline in Net Revenue
- EPY has substantially increased its Expected credit loss (ECL) provision to $14.1m (up a $13.4m on 1H'22) which included:
  - $9.6m RevRoof provision (across IF and Trade)
  - $3.1m specific provisions ($3.2m for Invoice and Trade Finance and ($0.1m) for Equipment Finance)
  - $1.4m general provisioning ($1.0m for Invoice and Trade Finance and $0.4m for Equipment Finance)
- This has resulted in a substantial PBT loss of $7.5m and a NPAT loss of $5.4m (including tax benefit)
- NTA remained strong at $45.4m or 15.6 cps
- Interim dividend was suspended and the Board will review the dividend at year-end

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Update on RevRoof

RevRoof entered voluntary administration on 7 December 2022 and was Earlypay's largest client, with an outstanding exposure of c. $30m across invoice, trade finance and equipment finance.

As the major secured creditor, Earlypay appointed Grant Thornton as Receiver and Manager ("R&M") over the assets of RevRoof to provide greater control over the recovery process. The R&M undertook a sale process and on 20 February 2023, entered into an agreement for the sale of the assets and business of RevRoof Pty Ltd.

The assets included in the sale include plant and equipment, stock, IP and transferring employees. Accounts receivable remain under the ownership of Earlypay and the Company continues to collect those receivables to reduce its exposure.

The purchaser of the assets and business of RevRoof is the Design Group. The sale is conditional on the assignment of two property leases to Design Group from the current landlords of Revroof.

The sale does not include the assets of PST. Whilst the Receivers and Managers continue to work to recover amounts owed by that entity to creditors, including Earlypay, the Receivers have taken steps to shut down the operations of PST.

Following the sale of RevRoof Pty Ltd and the revised expectation that the Company will not recover a significant portion of its exposure, it is recognising a specific provision of $9.6m in the half year ending 31 December 2022. It is also expected that c. $2m of receivership related costs will be incurred in H2'23.

Operational Updates

The significant RevRoof loss in H1'23 was a major disappointment for the Company and we are actively addressing the shortcomings that led to this outcome.

Thorough investigations have identified the root causes of the loss, and changes have been implemented to our Corporate Risk Governance framework, underwriting processes and decision-making, and operational policies and procedures. It also reinforced the need to continue to invest in our proprietary software and data infrastructure and retire less sophisticated legacy platforms.

Importantly, the RevRoof exposure was outsized relative to our loan portfolio and net assets. We have significantly reduced our maximum single borrower exposure limit to $10m, which now largely aligns with our next largest client exposures. The exposure limit will continue to be refined by the Board to be consistent with its risk appetite. This will lead to a more diversified portfolio of clients and debtor exposures mitigating the impact on the business of any single borrower failure in the future.

While the RevRoof loss was significant, our capital base remains strong.

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1H'23 Proforma Results (Underlying results excluding RevRoof)

***Note:** From this point, figures presented are unaudited and proforma to present an 'underlying' profile of the business on a continuing basis, excluding the income, expenses and ECL provisions relating to RevRoof[1]. RevRoof was Earlypay's largest client who went into administration on 7 December 2022. A reconciliation of proforma to reported figures can be found in the Investor presentation lodged with the ASX.*

Highlights

- Average FIU was up 33% on pcp to $316m
- Net revenue of $21.2m was down 6% on pcp reflecting higher interest costs offsetting higher Interest Income
- Expected credit loss (ECL) of $4.5m (up $3.8m on pcp) including:
  - Specific provision of $3.1m
  - General provision of $1.4m
- Underlying Proforma NPAT of $1.6m

Profit and Loss ($m)	1H'22 Proforma	1H'23 Proforma	*Δ pcp*
Average Funds in Use	*236.9*	*316.2*	*33%*
Interest income	12.4	17.1	37%
Interest expense	(4.0)	(8.8)	121%
Mgmt / Admin Fees	14.1	13.0	-8%
Net revenue	**22.5**	**21.2**	**-6%**
Opex	(14.4)	(15.8)	*10%*
Expected Credit Loss (ECL)	(0.7)	(4.5)	526%
PBT	**7.5**	**0.9**	**-88%**
One-offs	-	0.9	na
Amortisation	0.8	0.5	-33%
Underlying PBT	**8.2**	**2.3**	**-71%**
Underlying NPAT	**6.6**	**1.6**	**-75%**
EPS (cents per share)	2.4	0.6	-79%
DPS (cents per share)	1.4	-	na
Net interest margin	*10.4%*	*10.7%*	*3%*
Net revenue margin	*18.9%*	*13.3%*	*-29%*
Cost to Income	*63.7%*	*74.6%*	*17%*
ROE	*16.2%*	*1.2%*	*-92%*

"One-offs" include restructuring costs and an adjustment for previously recognised EF income

At a segment level (please refer to investor presentation for more detail), both Invoice & Trade Finance and Equipment Finance experienced strong organic growth in FIU resulting in stronger interest income. Due to the reasons explained below interest expense has offset interest income resulting in lower net revenue and subsequently net interest and revenue margins.

Margins

Net Interest Margins and Net Revenue Margins have contracted in recent periods for reasons that include:

- the impact of a full period of interest expense from the $30m trade facility that commenced in April 2022 when there was no Trade Finance related interest expense in H1'22;
- the Asset and Liability rate mismatch resulting from the $20m variable rate corporate bond and the $13m (drawn) variable rate Equipment Finance warehouse that fund fixed rate assets;
- a delay in fully passing on the increase in our funding costs to Invoice and Trade Finance clients in Q1 as clients were recontracted to the Earlypay variable base rate;
- onboarding larger Invoice and Trade Finance clients at tighter margins; and
- relatively large EF originations in H2'21 / H1'22 at margins tighter than the existing book.

Some of these factors relate to client pricing which has been addressed, but the most material impact on our margins is the level of our cost of funding.

Funding

To address the margin compression resulting from higher interest expense, Earlypay is in the process of reviewing all funding arrangements with a view to refinancing in early Q1'FY24, with objectives to:

- rationalise the existing warehouses into a single facility (or maximum of two facilities);
- achieve a more capital efficient structure (first loss contribution);
- reduce the operational capital required to support existing funding arrangements;
- enhance the scalability of the warehouse funding;
- utilise surplus cash to reduce or repay the Corporate Bond;
- achieve a lower overall cost of funding; and
- simplify the treasury function.

The execution of this strategy is critical for Earlypay to recover margin and resume earnings growth.

Outlook

FY23 will be a period of transition as the business learns from and moves past RevRoof. Earlypay believes this is the bottom of the earnings cycle and expects 2H'23 Proforma NPAT to materially higher than 1H'23 driven by continued organic growth in FIU and lower general ECL provisions (compared to Proforma 1H'23)

In FY24, Earlypay **e**xpects growth to continue building on 2H'23 momentum, through:

- Organic growth – to continue with a focused, marketing led distribution for Invoice Finance
- Improvements in NIM to be driven by:
  - Warehouse funding enhancements and the retirement of expensive debt will drive significant cost savings; and
  - Building a more diversified client base, with no outsized exposures, will bring a shift to a lower average client sizes that typically have higher margins.
- Continued focus on cost control as earnings bounce back.

Earlypay CEO James Beeson said of the 1H'23 result:

"The RevRoof loss is hugely disappointing and a comprehensive review of this event, and our business more generally, has been undertaken to identify the shortcomings that led to a failure of this scale. As a result, we have promptly implemented change at all levels of the business including corporate governance, risk management (including a much lower single borrower exposure limit), underwriting policies, operational policies and procedures, and how we service our clients and referrers.

Although the short-term financial impact of the loss is significant, we are confident that we are now operating with stronger foundations on which we can resume strong and sustainable growth.

Outside of RevRoof and the additional ECL provisioning in H1'23, the Earlypay business remains strong. We have a clear strategic view of how we can continue to grow funds in use and recover lost margin, mostly by improving our funding structures. These initiatives are critical for driving Net Revenue and profitability back to previous levels and beyond. Most importantly, we look forward to earning back the trust of our investors, funders and other stakeholders."

This release was authorised by the Board of Earlypay Limited.

-- ENDS --

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ABOUT EARLYPAY

Earlypay provides secured finance to SMEs in the form of invoice, equipment, and trade financing.

Earlypay's core product is invoice financing which can help SMEs overcome the cash flow pressure of waiting up to 60 days to receive payment of their customer invoices. Typically, Earlypay will provide SMEs with up to 80% of the invoice amount and funds can be used for any business purpose. Because invoice finance is supported by outstanding invoices, available funding increases in line with sales volume and is well suited to growing businesses.

Earlypay also provides SMEs with finance to invest in equipment and vehicles, and can also offer trade finance to clients to pay their suppliers.