Garfunkelux Holdco 2 S.A.
Accounting Teach-In Session

June 12th, 2018

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Presenters

Claire Johnson

Group Financial Controller

- Joined the Group in June 2015
- Qualified with Deloitte 1997
- Over 20 years experience
- Experience of working in Financial Services and International FTSE/AIM listed Plc's

Jon Trott

Head of Investor Relations

- Joined the Group in October 2013
- 12 years of Financial Services experience
- Previously with HSBC, Santander and General Electric

Setting Our Agenda

How do I differentiate between income from portfolio investments and net portfolio write-up?

How do you calculate amortisation?

What IFRS and non-IFRS measures do you report?

What assumptions do you make to derive your ERC replacement rate figure?

How does Operating Profit walk to Cash EBITDA?

How does quoted NPL portfolio acquisitions tie to the Cash-Flow statement?

Agenda

1. “GH2” Income Statement – A Walk Through

Garfunkelux Holdco 2 S.A. Income Statement

A Walk Through

3 months ended 31 March 2018	£000
Income	
Income from portfolio investments	68,700
Net portfolio write up	14,312
Portfolio fair value release	(497)
Service revenue	36,315
Other revenue	825
Other income	360
Total income	**120,015**
Operating expenses	
Collection activity costs	(58,315)
Other expenses	(40,918)
Total operating expenses	**(99,233)**
Operating profit	**20,782**
Finance income	155
Finance costs	(50,215)
Profit / (loss) before tax	**(29,278)**
Tax credit	485
Profit / (loss) for the period	**(28,793)**

2. IFRS Accounting In Focus – IFRS 9 Amortised Cost (EIR)

IFRS Accounting In Focus – IFRS 9 Amortised Cost (EIR)

Setting The Scene – Our Income Statement And Balance Sheet

Income Statement

3 months ended 31 March 2018	£000
Income	
Income from portfolio investments	68,700
Net portfolio write up	14,312
Portfolio fair value release	(497)
Service revenue	36,315
Other revenue	825
Other income	360
Total income	**120,015**
Operating expenses	
Collection activity costs	(58,315)
Other expenses	(40,918)
Total operating expenses	**(99,233)**
Operating profit	**20,782**

Balance Sheet

31 March 2018	£000
Assets	
Non-current assets	
Goodwill	1,197,119
Intangible assets	167,532
Property, plant and equipment	11,966
Portfolio investments	859,734
Other assets[1]	14,673
Total non-current assets	**2,251,024**
Current assets	
Portfolio investments	521,280
Inventories	104
Trade and other receivables	90,650
Other assets[2]	8,632
Cash and cash equivalents	114,987
Total current assets	**735,653**
Total assets	**2,986,677**

The entries shown on the face of the financial statements when accounting for acquired portfolio investments under IFRS 9

[1] Comprises Other financial assets and Deferred tax assets. [2] Comprises Other financial assets and Assets for current tax

IFRS Accounting In Focus – IFRS 9 Amortised Cost (EIR)

Establishing The Effective Interest Rate

- The EIR is the rate that exactly discounts estimated future cash receipts of the acquired portfolio asset to the net carrying amount at initial recognition (i.e. the price paid to acquire the asset)
- These estimated future cash receipts are reflective of the conditions within each market the Group operates and range from 84 months to 120 months
- A simplified worked example…

Example	£
Year 0 (Day 1)	(1,000)
Year 1	600
Year 2	500
Year 3	410
Year 4	330
Year 5	260
Year 6	200
Year 7	150
EIR (annual)	**40.5%**

In this example, this is purely the purchase price of the portfolio

Gross collections over 84 months

40.5% being the **rate that exactly discounts the gross collections back to the £1,000 purchase price**

IFRS Accounting In Focus – IFRS 9 Amortised Cost (EIR)

Interpreting The Underlying Principles

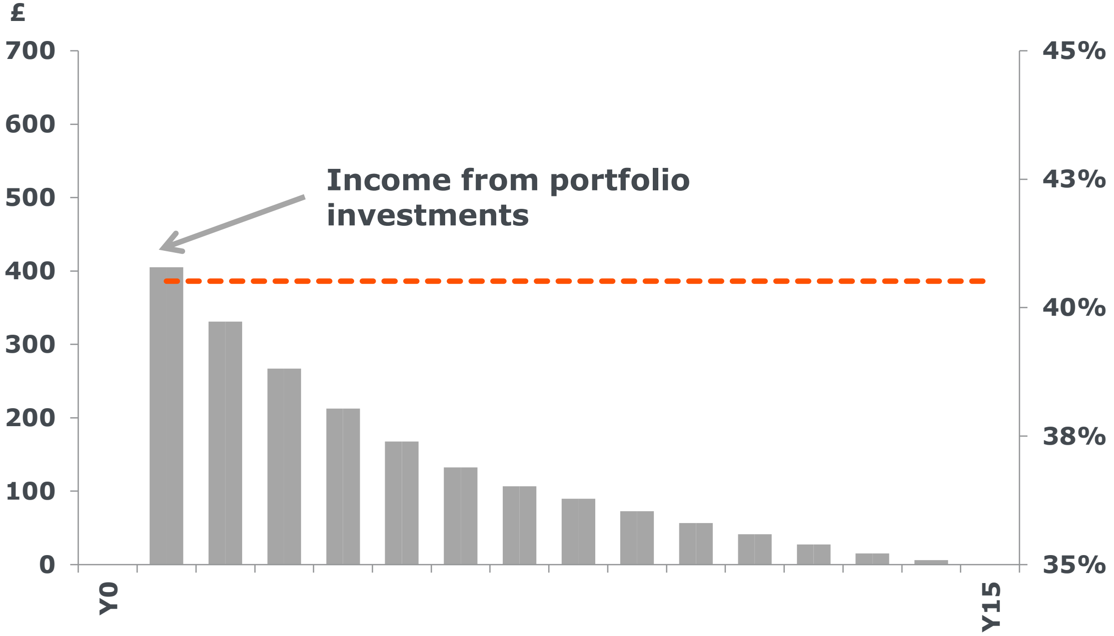
Acquired portfolio investments are a financial asset ("contractual right to receive cash")

Cash Recognition

- Given nature of these portfolio investments (Non-Performing Loans), typically cash profiles are front-end loaded

Amortised Cost, EIR Recognition

- Under EIR, we recognise a constant yield over the life of the portfolio

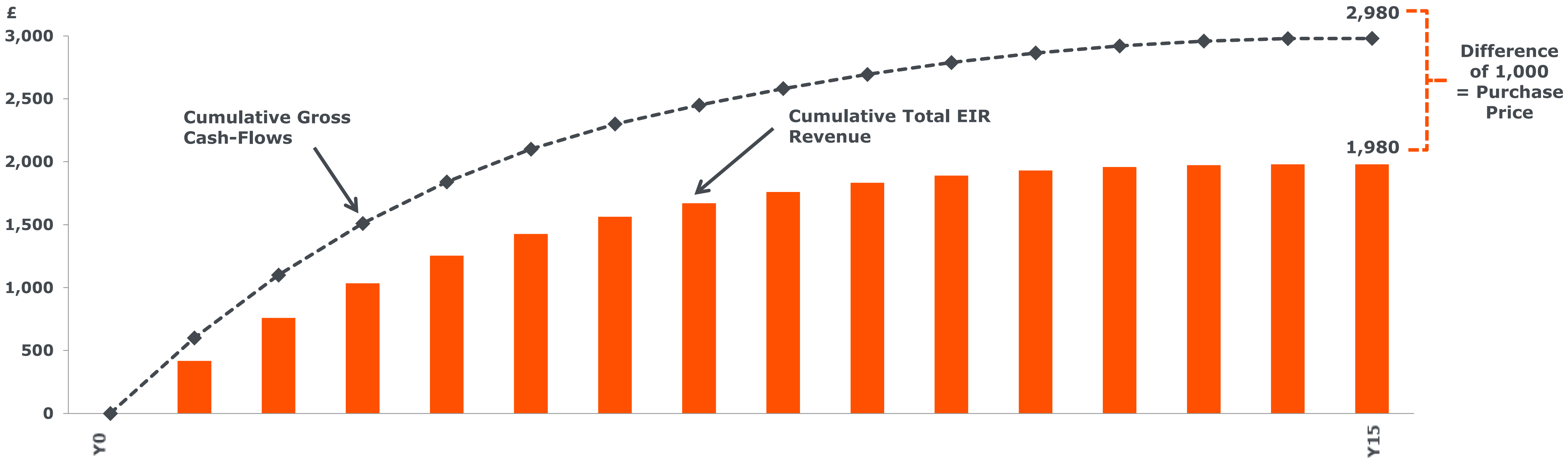


[1] *For the purposes of this simplified illustration, we have assumed a portfolio with a 15 year life i.e. no further collections expected after 15 years*

IFRS Accounting In Focus – IFRS 9 Amortised Cost (EIR)

Interpreting The Underlying Principles

Over the life of the portfolio…
Cumulative Gross Cash-Flows Less Purchase Price = Cumulative Total EIR Revenue



Cumulative Gross Cash-Flows = Gross collections over life of the portfolio

Cumulative Total EIR Revenue = Income from portfolio investments plus Net portfolio write-up over life of the portfolio

IFRS Accounting In Focus – IFRS 9 Amortised Cost (EIR)

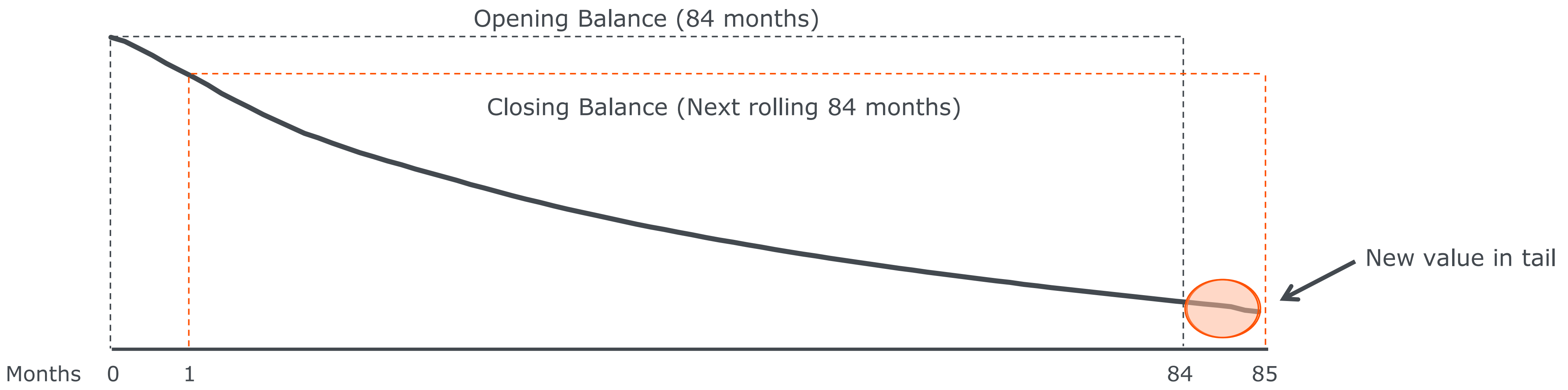
Insight Into Net Portfolio Write-Up ("Revaluation")

Drivers of "Revaluations" – Two Main Components

1. Time Period Roll-Forward – Static Curve

A 'mechanical' calculation that drives revaluation through rolling-in the value present in the tail of the collections curve (the 85th / 121st month)

Rolling 84 Month Example…



IFRS Accounting In Focus – IFRS 9 Amortised Cost (EIR)

Insight Into Net Portfolio Write-Up (“Revaluation”)

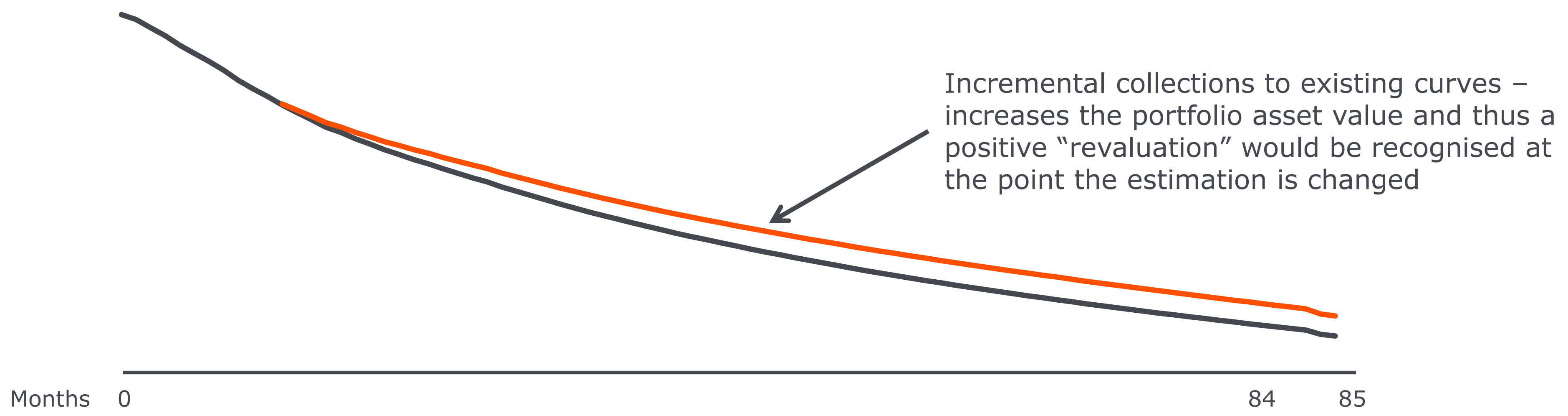
Drivers of “Revaluations” – Two Main Components

2. Revaluation from Incremental Collections

- A period of over-or under-performance versus collections expectations leading to an uplift or reduction in expected collections
- An on-going focus across the Group to drive sustainable incremental collections from paying or non-paying accounts by leveraging continuous improvements

A period of collections over-or under-performance leading to an adjustment in the carrying value of the portfolio by revising the estimated cash flows

Incremental Collections Uplift…



IFRS Accounting In Focus – IFRS 9 Amortised Cost (EIR)

Initial & Subsequent Recognition

- Based on our illustrative simplified portfolio…

Example	**£**					
Purchase price	1,000					
Portfolio EIR	40.5%					
	Y0	Y1	Y2	Y3	Y4	Y5
Portfolio investment (opening asset value)	**0**	**1,000**	**817**	**659**	**524**	**414**
Gross collections		3 (600)	(500)	(410)	(330)	(260)
Purchase price	1 1,000					
Income from portfolio investments		4 405	331	267	212	168
Net portfolio write-up		5 12	10	9	7	5
Portfolio investment (closing asset value)	**1,000**	2 **817**	**659**	**524**	**414**	**327**

- Year 0 (Day 1);
  1. Asset recognised equal to the purchase price
- Year 1 (and subsequent points);
  2. Asset value recorded represents the next 84 months gross collections discounted using the portfolio's specific EIR rate
  3. Actual gross collections netted off
  - Two items are recorded on the income statement;
    4. Income from portfolio investments ("Yield") being the opening asset value multiplied by the portfolio's specific EIR
    5. Net portfolio write-up ("Revaluation")

3. Non-IFRS Metrics In Focus – i) Key Reconciliations

Non-IFRS Metrics In Focus

The Key Non-IFRS Metrics We Disclose to Aid Transparency, Insight and Understanding

Metric	Definition	Why Do We Disclose?
Cash Income	Total income for the period adding back portfolio amortisation and portfolio fair value release and deducting net portfolio write-up, lawyer service revenue, other revenue and other income	Visibility of collections on assets owned and the fees and commissions, which are earned from our servicing activities
Cash EBITDA	Collections on owned portfolios plus other turnover, less collection activity costs and other expenses and before exceptional items, depreciation and amortisation	Visibility of our underlying cash-flow generation at a given point in time that can be used to service or pay down debt, pay income taxes, purchase new debt portfolios and for other uses
Gross Profit	Cash Income less normalised Collection activity costs	Segment (DP and 3PC) level visibility of gross profit and returns
Portfolio Amortisation	The difference between gross collections for the period and Income from portfolio investments	The reconciliation of debt purchase income (“yield”) to gross cash collections
ERC	Estimated Remaining Collections over 84, 120 or 180 months	Represents our expected gross cash proceeds of the purchased debt portfolios recorded on our balance sheet
ERC replacement rate	An estimate of the level of purchases required to keep Group ERC flat	Visibility of the replacement rate when considering steady-state modelling
Portfolio acquisitions	The purchases of unsecured, consumer credit NPLs	The level of investments the Group is making in new portfolio acquisitions

Non-IFRS Metrics In Focus

Key Reconciliations – Portfolio Amortisation

EIR – Portfolio Amortisation

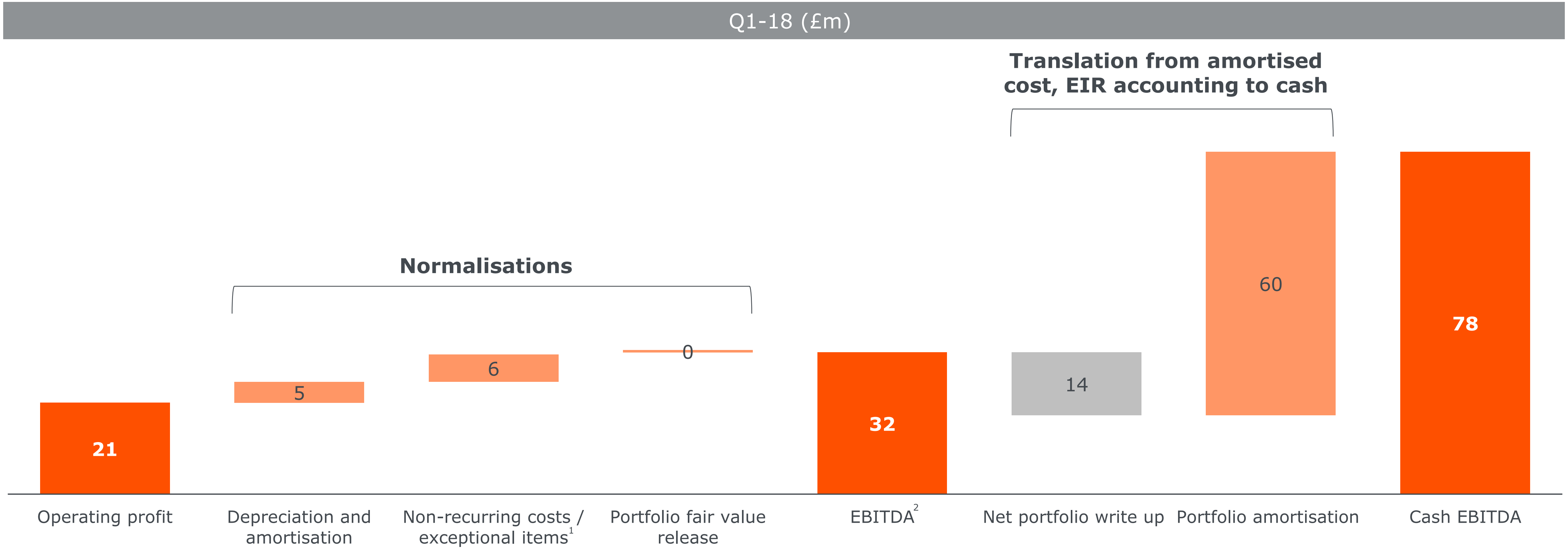
- Quite simply the difference between
  - Gross collections for the period and;
  - 'Income from portfolio investments' ("Yield")
- Using our illustrative simplified portfolio…

Example		**£**
		Y1
Gross collections	3	600
Income Statement		
Income from portfolio investments	4	405
Net portfolio write up		12
Portfolio Amortisation	(3 - 4)	**195**

- Important to remember that amortisation is a backward looking metric

Non-IFRS Metrics In Focus

Key Reconciliations – Reported IFRS Operating Profit to Cash EBITDA

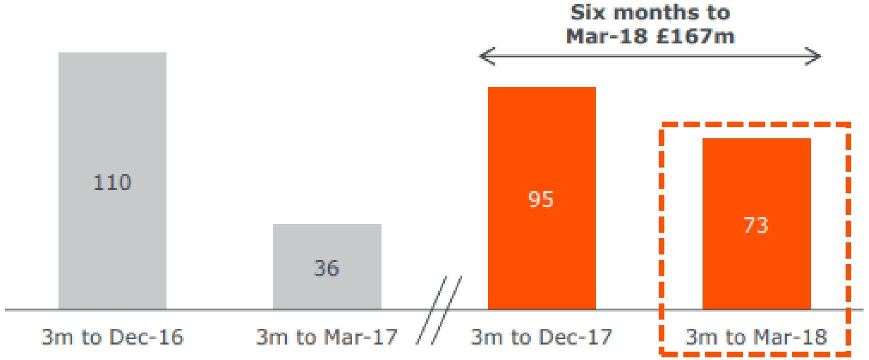


[1] Net of exceptional income. 2 Defined as Operating Profit plus Depreciation & Amortisation, Non-recurring Costs and Exceptional Items (net of exceptional income) and Portfolio Fair Value Release.

Non-IFRS Metrics In Focus

Key Reconciliations – Portfolio Acquisitions

GH2 Q1-18 Investor Presentation, P8



GH2 Q1-18 Interim Financial Statements, P16

4. Portfolio investments

	31 March 2018 £000
At start of the period	964,507
Portfolios acquired during the period	72,832
Portfolios acquired through acquisition of subsidiary	389,078
Collections in the period	(128,629)
Income from portfolio investments	68,700
Net portfolio write up	14,312
Portfolio fair value release	(497)
Other	711
At end of the period	**1,381,014**

GH2 Q1-18 Interim Financial Statements, P19

9. Note to the statement of cashflows

	Note	3 months to 31 March 2018 £000
Loss for the period before tax		**(29,278)**
Adjustments for:		
Income on portfolio investments	4	(68,700)
Net portfolio write up	4	(14,312)
Portfolio fair value release	4	497
Collections on owned portfolios	4	128,629
Depreciation and amortisation		4,782
Finance income		(155)
Finance costs	3	50,215
Unrealised (losses)/gains from foreign exchange		(536)
Increase in trade and other receivables		(5,858)
Decrease in trade and other payables		(2,137)
Movement in other net assets		(5,262)
Cash generated from operating activities before portfolio acquisitions		**57,885**
Portfolios acquired [1]		(80,868)
Net cash used in operating activities		**(22,983)**
Income taxes paid		(259)
Net cash used in operating activities		**(23,242)**

Portfolios acquired per the 'note to the statement of cashflows' represents the amount paid for portfolio purchases in the period, taking into account timing differences

3. Non-IFRS Metrics In Focus – ii) ERC Replacement Rate

Non-IFRS Metrics In Focus – ERC Replacement Rate

Pro Forma Group (£m)		
		Mar-18
	Group ERC[1]	3,018
	Year 1 Collections	597
	Roll-forward *(UK – YR11, DACH & Nordics – YR16)*	91
A	Collections to replace	506
	2017 vintage Static GMM	2.1x
	2018 vintage Static GMM	1.9x
B	Blended Static GMM[2]	2.0x
A/B	Mar-18 Replacement Rate	~258
	Mar-17 Replacement Rate	~198
	Average LTM Replacement Rate[3]	~228

What do we mean by ERC Replacement Rate?

- An estimate of the level of purchases required to keep Group ERC flat
- A static, point in time calculation, under steady-state assumptions
- Simplistic calculation that considers two variables:
  - Forecast collections, being the next 12 months ERC and value in the tail; and
  - Recent actual, static GMMs

Why do we include it?

- Understand importance of the replacement rate when considering steady-state modelling

[1] Group ERC represents 120m for UK, 180m for DACH and Nordics. [2] Blended GMM represents the weighted average static GMM for 2017 and 2018 vintages, across the UK, DACH and Nordics as at Mar-18.
[3] Average Replacement Rate is an average of the Replacement Rate as calculated at Mar-17 and the Replacement Rate as calculated at Mar-18.

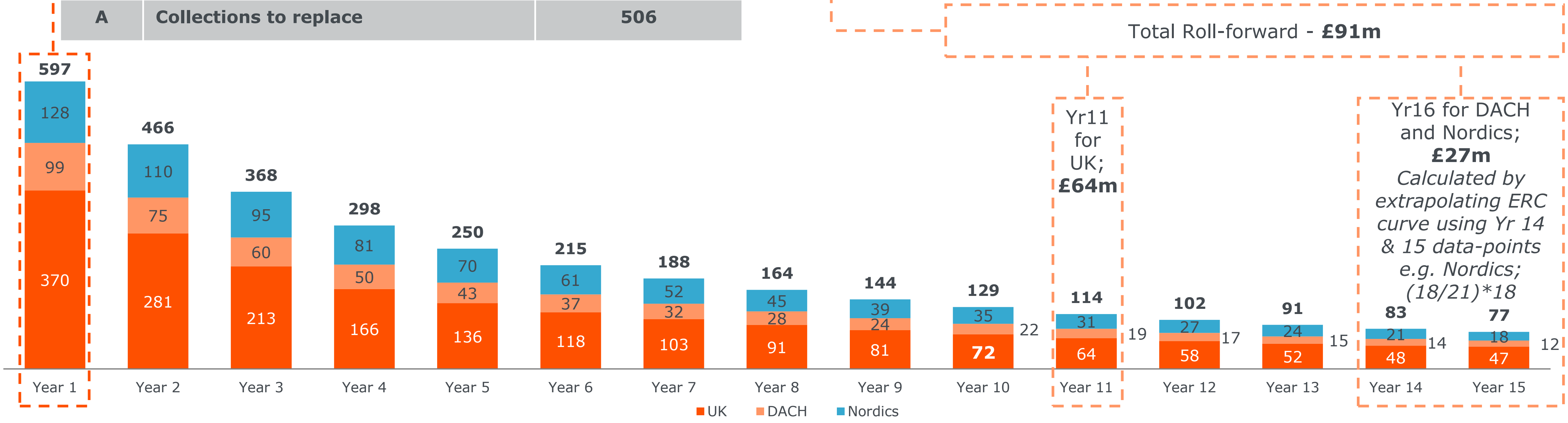
Non-IFRS Metrics In Focus – ERC Replacement Rate

Calculation Insight – Step 1 – 'Collections to replace'

Pro Forma Group (£m)		
		Mar-18
	Group ERC	3,018
	Year 1 Collections	**597**
	Roll-forward *(UK – YR11, DACH & Nordics – YR16)*	**91**
A	**Collections to replace**	**506**

Collections to replace

- Based upon ERC profile by year as reported (using Q1-18 disclosure)
- Next 12 months collections ("Year 1 Collections") of £597m, less;
- Value that will roll-in from the tail over the next 12 months ("Roll-forward");
    - UK (Yr11); £64m
    - DACH (Yr16 extrapolated); £11m
    - Nordics (Yr16 extrapolated); £16m



Non-IFRS Metrics In Focus – ERC Replacement Rate

Calculation Insight – Step 2 – Recent, Actual Static GMMs

Pro Forma Group (£m)

		Mar-18
	Group ERC	3,018
	Year 1 Collections	597
	Roll-forward *(UK – YR11, DACH & Nordics – YR16)*	91
A	Collections to replace	506
	2017 vintage Static GMM	**2.1x**
	2018 vintage Static GMM	**1.9x**
B	Blended Static GMM	**2.0x**

GMM Weighted Average Calculation

2017 Vintage	UK	DACH	Nordics	Total
Purchases (£m)	213	43	131	387
% of total purchases	*55%*	*11%*	*34%*	*100%*
Actual Static GMM	2.0x	2.8x	1.9x	
Weighted Average				**2.1x**

2018 Vintage Actual Static GMM of **1.9x**, as reported (Q1-18 disclosure), using the same purchase-weighted average calculation as above

Blended Static GMM, being a simple average of the two vintage Static GMMs

Non-IFRS Metrics In Focus – ERC Replacement Rate

Calculation Insight – Step 3 – Average LTM Replacement Rate

Pro Forma Group (£m)		
		Mar-18
	Group ERC	3,018
	Year 1 Collections	597
	Roll-forward *(UK – YR11, DACH & Nordics – YR16)*	91
A	**Collections to replace**	**506**
	2017 vintage Static GMM	2.1x
	2018 vintage Static GMM	1.9x
B	**Blended Static GMM**	**2.0x**
A/B	**Mar-18 Replacement Rate**	**~258**
	Mar-17 Replacement Rate	**~198**
	Average LTM Replacement Rate	**~228**

Why do we calculate and quote an average replacement rate?

- The average replacement rate is a two-point average of the replacement amount calculated at the start of the period and at the end of the period
- It is this average that we apply when we consider the 'steady-state' cashflow generation waterfall
- We use an average to account for the fact that the start point of this waterfall, our Cash EBITDA, is a lagged measure i.e. it does not yet include the material and incremental cash-flows from our most recent purchases

4. IFRS Accounting – Recent Reporting Changes & Future Reporting

IFRS Accounting – Recent Reporting Changes

IFRS 9 – Financial Instruments – Effective 1st January 2018

Three Main Areas

1. Classification and Measurement

    a) Fair Value Through P&L

    b) Fair Value Through Other Comprehensive Income

    c) Valuation at Amortised Cost

2. Impairment – “expected” credit losses

3. Hedging

➢ Amortised cost remains the appropriate accounting policy for Group

IFRS Accounting – Recent Reporting Changes

IFRS 9 – Financial Instruments – Changes to the Income Statement

Understanding the IFRS 9 Restatement of the Prior Year Comparative

£000	Q1-17 Under IAS 39	Q1-17 IFRS 9 Transition	Q1-17 Under IFRS 9
Income			
Income from portfolio investments	57,241	-	57,241
Portfolio write up	27,574	(27,574)	-
Net portfolio write up	-	26,660	26,660
Portfolio fair value release	(641)	-	(641)
Service revenue	43,487	-	43,487
Other revenue	754	-	754
Other income	283	-	283
Total income	**128,698**	**(914)**	**127,784**
Total operating expenses	**(94,169)**	**914**	**(93,255)**
Operating profit	**34,529**	**-**	**34,529**

IFRS Accounting – Recent Reporting Changes

IFRS 15 – Revenue From Contracts With Customers – Effective 1st January 2018

Two Main Areas

1. IFRS establishes a five step plan

    a) Identify contract

    b) Identify performance obligation

    c) Determine transaction price

    d) Allocate transaction Price

    e) Recognise revenue

2. Impacts the 3PC element of the Lowell business

➢ Following our assessment of IFRS15, it's implementation has not had a material impact on the Group

IFRS Accounting – Future Reporting

IFRS 16 – Leases – Effective from 1st January 2019

Overview

1. Single on Balance Sheet approach to lease accounting for lessees
2. Likely impact on accounting for Property, Cars, IT assets previously treated as operating leases
3. Optional exemptions for short term leases of low value

➢ Management is assessing the potential impact of adopting IFRS16

5. Closing Remarks & Q&A

Closing Remarks

- Our teach-in is a key part of our continual efforts to provide thought leadership
- We appreciate as a key player in the industry, it is important for us to be at the forefront of educating our stakeholders
- We have consciously selected the topics presented today to aid your understanding and ultimately your modelling of our business
- Welcome feedback and any questions you may have…