Garfunkelux Holdco 2 S.A.

Accounting Teach-In Session

March 15th, 2017

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Presenters

Claire Johnson

Group Financial Controller

- Joined the Group in June 2015
- Qualified with Deloitte 1997
- c. 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
- 11 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 portfolio write-up?

How do you calculate amortisation?

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

How does Operating Profit walk to Cash EBITDA?

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

Our Agenda

I. “GH2” Income Statement – A Walk Through

II. IFRS Accounting – Amortised Cost (EIR)

III. ERC Replacement Rate

IV. Key Reconciliations

V. Future Reporting

VI. Q&A

Lowell. GROUP | GFKL Forderungsmanagement

I. “GH2” Income Statement – A Walk Through

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Garfunkelux Holdco 2 S.A. Income Statement

A Walk-Through

3 months to 30 September 2016	£000
Revenue	
Income from portfolio investments	50,885
Portfolio write up	33,992
Portfolio fair value release	(857)
Service revenue	41,250
Other revenue	746
Total Revenue	**126,016**
Other income	1,419
Operating expenses	
Collection activity costs	(49,477)
Other expenses	(36,367)
Total operating expenses	**(85,844)**
Operating profit	**41,591**
Interest income	282
Finance costs	(31,963)
Profit / (loss) before tax	**9,910**
Tax expense	(2,208)
Profit / (loss) for the period	**7,702**

I. “GH2” Income Statement – A Walk Through

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IFRS Accounting – Amortised Cost (EIR)

Setting The Scene – Our Income Statement And Balance Sheet

Income Statement

	3 months to 30 September 2016 £000
Continuing operations	
Revenue	
Income from portfolio investments	50,885
Portfolio write up	33,992
Portfolio fair value release	(857)
Service revenue	41,250
Other revenue	746
Total Revenue	**126,016**
Other income	1,419
Operating expenses	
Collection activity costs	(49,477)
Other expenses	(36,367)
Total operating expenses	**(85,844)**
Operating profit/(loss)	**41,591**

Balance Sheet

	30 September 2016 £000
Assets	
Non-current assets	
Goodwill	1,008,472
Intangible assets	133,251
Property, plant and equipment	8,967
Portfolio investments	431,824
Other financial assets	3,313
Total non-current assets	**1,585,827**
Current assets	
Portfolio investments	324,225
Inventories	8
Trade and other receivables	43,728
Other financial assets	13,113
Assets for current tax	1,199
Cash and cash equivalents	88,911
Total current assets	**471,184**
Total assets	**2,057,011**

The entries shown on the face of the financial statements when accounting for acquired portfolio investments under IAS39

IFRS Accounting – 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 (UK) to 120 months (DACH)
- A simplified worked 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

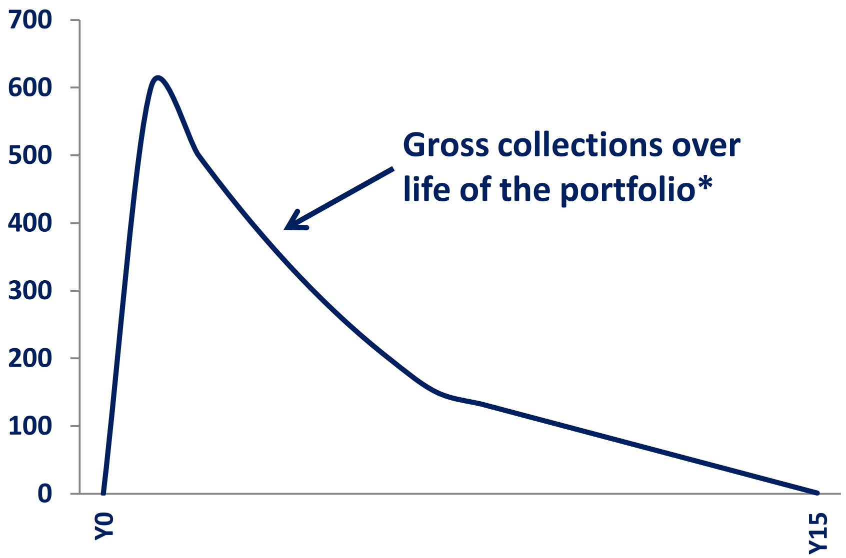
IFRS Accounting – Amortised Cost (EIR)

Interpreting The Underlying Principles

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

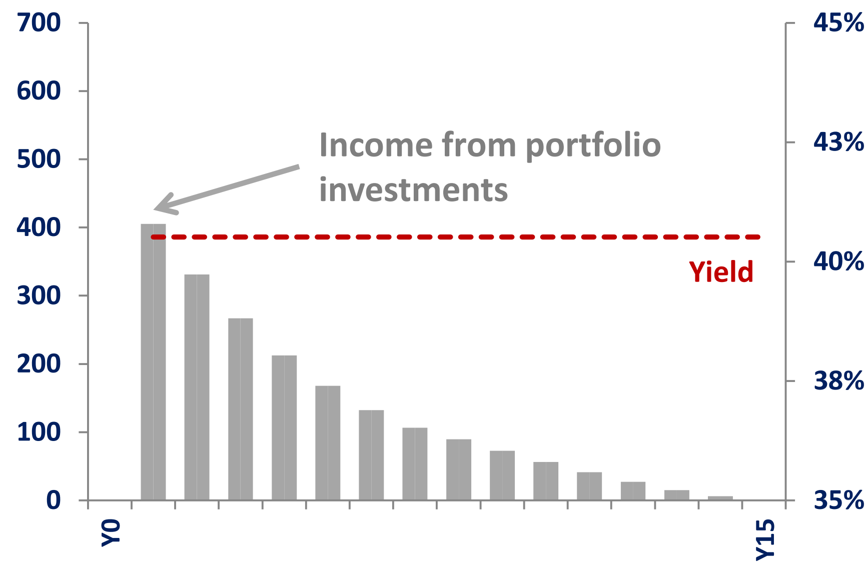
Cash Recognition

- 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

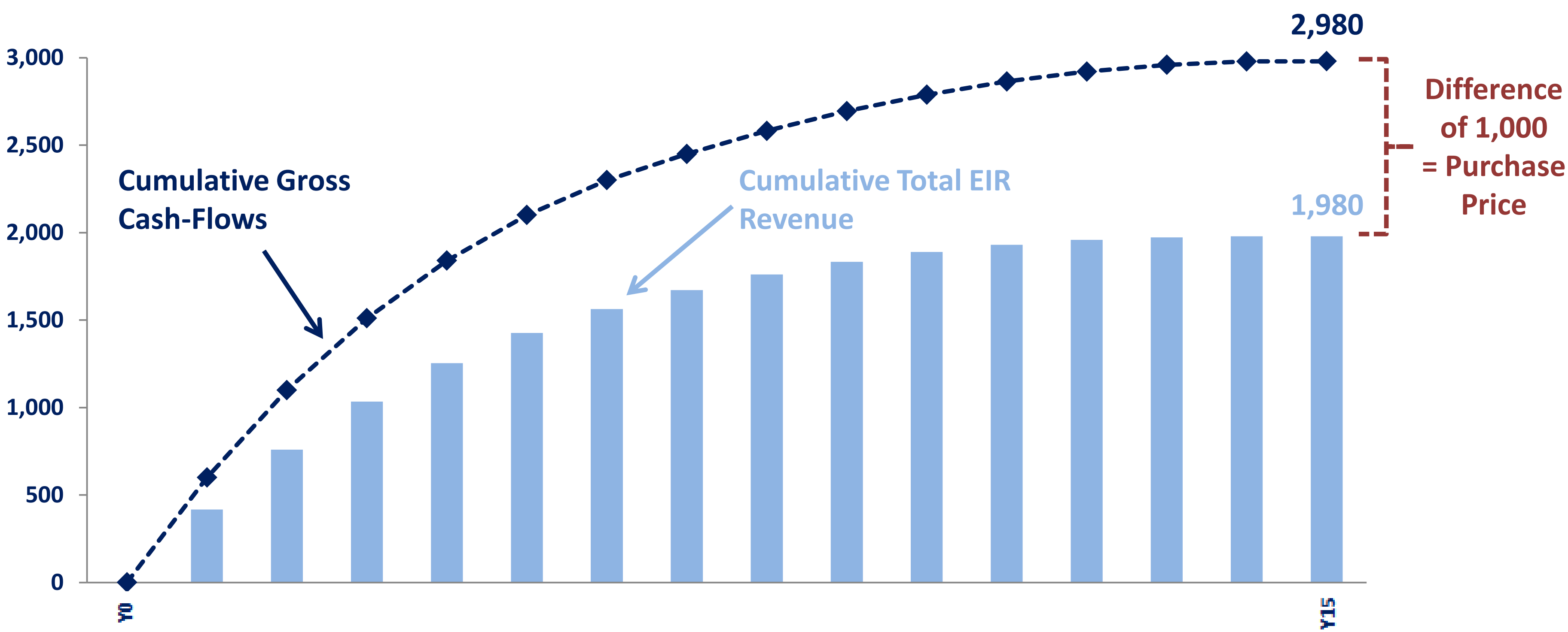


* For the purposes of this simplified illustration, we have assumed a portfolio with a 15 year life i.e. no further collections expected after 15 years

IFRS Accounting – Amortised Cost (EIR)

Interpreting The Underlying Principles

Over the life of the portfolio…
Cumulative Gross Cash-Flows <u>Less</u> 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 Portfolio write-up over life of the portfolio

IFRS Accounting – Amortised Cost (EIR)

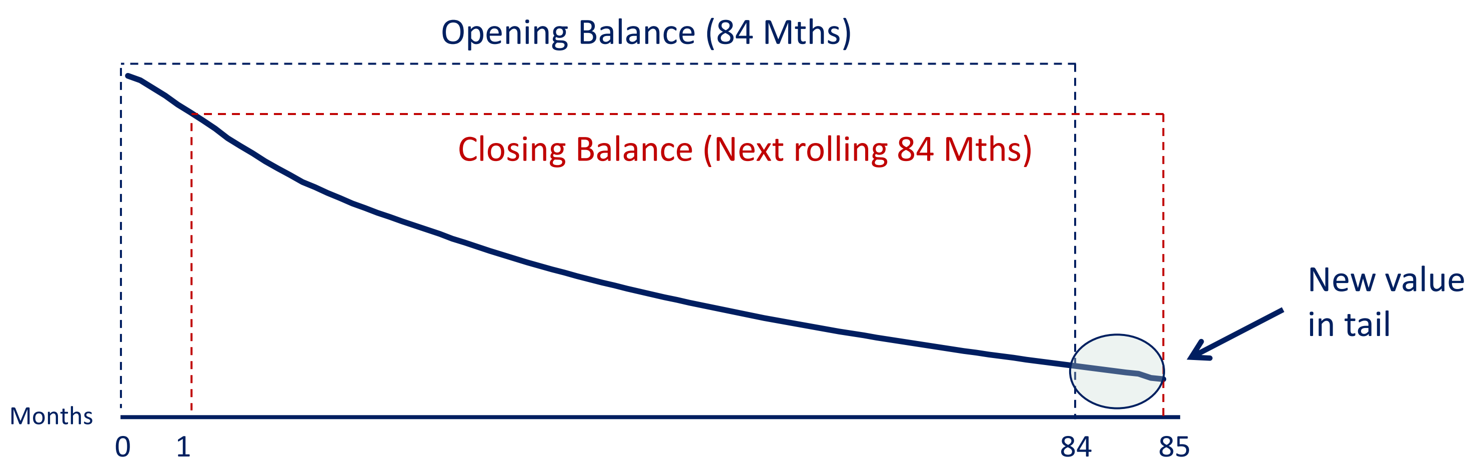
Insight Into Portfolio Write-Up ("Revaluation")

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 – Amortised Cost (EIR)

Insight Into Portfolio Write-Up (“Revaluation”)

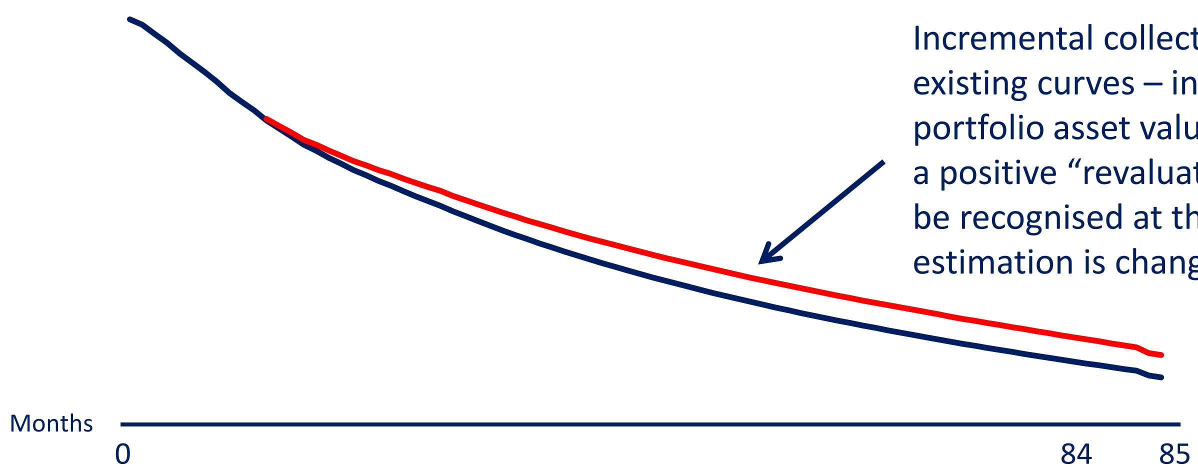
Drivers of “Revaluations” – Two Main Components

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…



Incremental collections to existing curves – increases the portfolio asset value and thus a positive “revaluation” would be recognised at the point the estimation is changed

IFRS Accounting – Amortised Cost (EIR)

Initial & Subsequent Recognition

- Based on our illustrative simplified portfolio…

		£					
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			(600)	3 (500)	(410)	(330)	(260)
Purchase price	1	1,000					
Income from portfolio investments			405	4 331	267	212	168
Portfolio write-up			12	5 10	9	7	5
Portfolio investment (closing asset value)		**1,000**	**817** 2	**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 Portfolio write-up ("Revaluation")

I. “GH2” Income Statement – A Walk Through

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ERC Replacement Rate

A Walk-Through

ERC Replacement Rate Formula (£m)

A B

$$\text{Replacement Rate} = \frac{\text{0 to12m collections} - \text{roll forward collections}}{\text{Gross Money Multiple}}$$

C

$$\text{Replacement Rate} = \frac{331 - (46 + 8)}{2.3\text{x}}$$

$$\text{Replacement Rate} = c.\,120$$

OM Extract (14 Sept 2016), page 45

ERC by Year as of June 30, 2016	Lowell ERC[1]	GFKL ERC[2][3]	Group ERC[4]
		(in £ millions) (unaudited)	
0 - 12 months	256	75	A 331
13 - 24 months	192	57	249
25 - 36 months	150	46	196
36 - 48 months	119	39	158
49 - 60 months	99	33	132
61 - 72 months	86	29	115
73 - 84 months	75	25	100
85 - 96 months	66	22	88
97 - 108 months	58 B	19	77
109 - 120 months	51	16	67
121 - 132 months	—	14	14
133 - 144 months	—	12	12
145 - 156 months	—	11	11
157 - 168 months	—	10 B	10
169 - 180 months	—	9	9
Total ERC	1,152	417	1,569

Notes

A 0-12m collections of £331m sourced from reported ERC profile in the latest OM

B Roll forward collections of the current ERC is calculated assuming the same decay rate as last period;

- Lowell: 51 * (51/58) = £46m
- GFKL: 9 * (9/10) = £8m

C We assume a blended Gross Money Multiple (GMM) based on our more recent vintages

- With GMM calculated as;

$$\frac{\text{Actual collections to date} + \text{120m Gross ERC}}{\text{Purchase price}}$$

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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…

		Y1
Gross collections	3	600
<u>Income Statement</u>		
Income from portfolio investments	4	405
Portfolio write-up		12
Portfolio Amortisation	(3 - 4)	**195**

- Important to remember that amortisation is a backward looking metric

Key Reconciliations – Cash EBITDA

Based On Q3-16 Results

GH2 Q3-16 Interim Financials, P19

Operating Profit to Cash EBITDA

Operating Profit to Cash EBITDA		3 months to 30 September 2016 £000
Operating profit		**41,591**
Portfolio amortisation	i	55,872
Portfolio write up	i	(33,992)
Portfolio fair value adjustment	i	857
Direct write-down of portfolios	ii	164
Non recurring costs / exceptional costs	ii	1,690
Depreciation and amortisation	ii	3,265
Cash EBITDA		**69,447**

i Add back;

- Portfolio Amortisation to derive Cash collections on owned assets

Deduct;

- Portfolio write-up (non-cash item)

ii Add back (consistent across both walks);

- Non-cash items
- Non-recurring items

Cash Collections to Cash EBITDA

Cash Collections to Cash EBITDA		3 months to 30 September 2016 £000
Cash collections	iii	106,757
Other income	iii	43,415
Operating expenses	iii	(85,844)
Non recurring costs / exceptional costs	ii	1,690
Direct write-down of portfolios	ii	164
Depreciation and amortisation	ii	3,265
Cash EBITDA		**69,447**

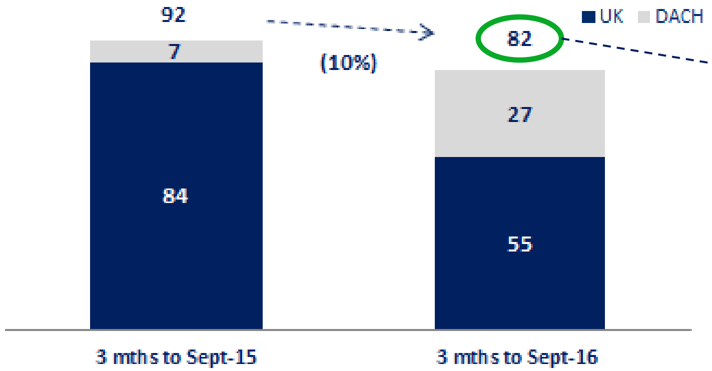
iii Walk starts from a cash basis

Key Reconciliations – NPL Acquisitions

Based On Q3-16 Results

GH2 Q3-16 Investor Presentation, P10

Quarterly NPL Portfolio Acquisition (£m)



GH2 Q3-16 Interim Financials, P17 (Note 3)

3. Portfolio investments	30 September 2016 £000
Opening balance	688,159
Portfolios acquired during the period	63,777
Portfolios acquired through acquisition of subsidiary	18,336
Collections in the period	(106,757)
Income from portfolio investments	50,885
Portfolio fair value release	(857)
Portfolio write-up	33,992
Write down of non-performing loans	(164)
Other	8,678
	756,049

Net Movement of £67,890k

GH2 Q3-16 Interim Financials, P11 (Cash-flow statement)

	3 months to 30 September 2016 £000
Profit/(loss) for the period before tax	**9,910**
Adjustments for:	
Depreciation and amortisation	3,265
Interest receivable	(282)
(Profit)/Loss on sale of property, plant and equipment and intangible as	5
Finance costs	31,963
Unrealised gains from foreign exchange	(2,265)
Increase in portfolio investments	(44,644)
Increase in trade and other receivables	(3,624)
Increase in trade and other payables	5,313
Movement in other net assets	1,246
Cash generated by/(used) in operating activities	**887**

Reconciliation

	£k
Net Movement (Note 3)	**67,890**
Deduct;	
- Portfolios acquired through acquisition of subsidiary	(18,336)
- Other – FX	(4,910)
Increase in portfolio investments	**44,644**

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Future Reporting

IFRS 9 – Financial Instruments

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

3. Hedging

I. “GH2” Income Statement – A Walk Through

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