THOMSON REUTERS

EDITED TRANSCRIPT

Q1 2020 General Motors Financial Company Inc Earnings Call - Prerecorded

EVENT DATE/TIME: MAY 06, 2020 / 12:00PM GMT

CORPORATE PARTICIPANTS

Daniel E. Berce *General Motors Financial Company, Inc. - President & CEO*
Stephen Jones *General Motors Financial Company, Inc. - VP of IR*
Susan B. Sheffield *General Motors Financial Company, Inc. - Executive VP & CFO*

PRESENTATION

Stephen Jones ***General Motors Financial Company, Inc. - VP of IR***

Welcome to GM Financial's First Quarter 2020 Earnings Presentation. This is Steve Jones, Vice President of Investor Relations at GM Financial. With me today are Dan Berce, President and CEO of GM Financial; and Susan Sheffield, Chief Financial officer.

Before we proceed, I must remind everyone that the topics we will discuss during this presentation will include forward-looking statements, which are the company's current views with respect to future events and financial performance. These forward-looking statements are subject to many assumptions, risks and uncertainties that could cause actual results to differ significantly from historical results or from those anticipated by us. The most significant of these risks are detailed from time to time in the company's filings and reports with the Securities and Exchange Commission, including the annual report on Form 10-K for the year ended December 31, 2019. If one or more of these risks or uncertainties materialize or if the underlying assumptions prove incorrect, our results may vary materially.

If you have questions on the material discussed, please feel free to contact me. My contact information can be found on both the earnings release and at the end of the presentation slides. We will be posting a transcript of this presentation to our website.

I will now turn the call over to Dan Berce. Dan?

Daniel E. Berce ***General Motors Financial Company, Inc. - President & CEO***

Thanks, Steve. I'll start with Slide 3. Our response to COVID-19 has focused on our employees and retail and dealer customers. From an employee standpoint, we're prioritizing their health and safety through a work-from-home initiative where virtually all of our employees are currently working from home. At the same time, we've made full capabilities for telephonic and digital customer service. We're currently preparing for a return to our facilities under a phased approach and enhanced safety protocols. As for retail customers, we've offered payment deferrals; end-of-lease term options, such as extensions; and fee waivers. Like many companies, with the lifting of restrictions, we are preparing for return to our facilities with a phased approach and enhanced safety protocols. We're supporting General Motors' go-to-market strategies by providing attractive financing offers for new loans and leases. And as I mentioned, we are enhancing our digital interactions with our customers to provide support in the purchasing process as well as back-end account servicing. With respect to our dealers, we're offering interest deferral and waiver of curtail payments on floor plan financing for 3 months, and we're deferring payments on dealer loans. We've also facilitated application to the Paycheck Protection Program through third-party SBA lenders.

Next slide, financial and operating highlights for our first quarter ended March 2020. Our earnings before taxes were down, primarily due to an increased loss provision, which Susan will discuss further, as well as a $39 million valuation adjustment on vehicle inventory. We expect greater impact on credit performance and residual values as we go throughout the remainder of the year. Our origination levels were impacted by changes in incentive financing programs in the U.S. and lower industry sales year-over-year. Our ending earning assets were down slightly year-over-year to $96.1 billion. With respect to customer experience, we continue to lead the overall industry in manufacturer loyalty, and we've accelerated our rollout of chatbot technology to drive digital customer contact. We were active in the funding markets. In the quarter, we issued $6.7 billion in public and private debt securities and renewed 5 credit facilities totaling $1.8 billion. And importantly, in April, we reopened the ABS market with a prime auto loan transaction, which was the first since early March. Finally, we paid a $400 million dividend to General Motors in March.

Next slide, GM and GM Financial penetration statistics. Our penetration of GM retail sales in the U.S. was 44.8% in the first quarter, up from the fourth quarter of 2019 but down from the first quarter of 2019. I'll remind you that our U.S. retail penetration levels are highly dependent on the types of incentives GM has in the market. In fact, in the month of April, our penetration level is above 55% driven by launch of the 0% for 84-months offer with no payments for 120 days. Penetration remains stable in Latin America.

Next slide, retail loan originations and portfolio balance. Our retail loan portfolio increased slightly year-over-year to $42.5 billion from $41.8 billion a year ago. During the quarter, we originated $6.5 billion of new loans, of which $4.2 billion was financing a new GM vehicle. Our FICO score for the first quarter of 2020 was 707, down from a year ago when it was 737. Origination volume and loan mix, like penetration, are also dependent on the type of incentive programs that GM has in the market. For the month of April, our FICO score is running 745 plus, again, just because of the 0 for 84-months offer.

Next slide, retail loan credit performance. For the first quarter, year-over-year delinquency and net charge-offs were only slightly impacted by the late Q1 timing of COVID-19. The rest of the year, we expect our credit metrics to worsen due to the weak economic environment globally. Net charge-offs will increase as we have temporarily suspended repossession activity, and any accounts that go 120 days past due will be charged off in full. We expect our annual net charge-offs for 2020 to range between 2% and 2.5%. As I mentioned previously, we are offering payment deferrals to our customer base to provide them with payment options. Payment deferral activity has positively impacted delinquency as accounts are generally brought current through the deferment process.

Next slide. With respect to our retail loan support, this slide has specific data on our payment deferral activity. Starting at the top, for the months of January and February, which were fairly normal in terms of deferral activity, our deferment rates were 1.2% and 0.9%. Deferrals began to be elevated in the second half of March where they reached 1.6% and the level was 3.5% for the month of April. Our distribution of deferrals has also skewed a bit with more accounts that are current receiving a deferral and more prime customers receiving a deferral.

Next slide. I'll turn to operating lease originations and portfolio balance. Our lease portfolio declined year-over-year to $41.3 billion from $43.1 billion a year ago as GM's lease mix has been slightly lower over the last 5 quarters and also a decrease in leasing activity in late March with the closing of many dealerships in high-lease markets. The lease portfolio is high credit quality with FICO scores in the 770s and a delinquency rate of over 30 days of just 0.8% at the end of the first quarter of 2020. We have done contract extensions for customers that ended their lease terms so they can remain in their vehicle beyond the scheduled lease termination date. And in April, we launched a payment deferral option for lease customers where they can take a lease payment or 2 and add it to the very back of the lease.

GM Financial used vehicle trends. This slide illustrates our returned vehicle sales proceeds versus ALG residuals at origination. The first quarter of 2020 was developing quite strongly prior to late March. Since then, sales volumes and pricing are off. For the full year, industry forecasts estimate a 7% to 10% decline in used vehicle prices in 2020 compared to 2019. We are accelerating our depreciation expense in 2020 in line with these estimates, and the depreciation will be weighted more heavily to 2020 maturities.

Next slide, a few words about our process for reviewing lease impairment. As I just discussed, residual values are reviewed quarterly based upon updated marks provided by a third-party research firm. We also perform reviews quarterly for indicators of impairment and recovery of our leased vehicles by asset group categorized by year, make and model. Asset group recovery is calculated as the excess of the sum of the remaining lease payments, plus estimated residual value, over our leased vehicles, net, less deferred income. Based on those asset groups, there was no impairment as of March 31, 2020. If the residual review was done at the portfolio level instead of by asset group, which is required to be done, we would have an economic cushion of $3.7 billion, which is equal to 12.5% of our residual value estimate at March 31, 2020.

Next slide, commercial lending. Our commercial lending portfolio reached 1,890 dealers and $12.3 billion at quarter end, down just a bit from the level of a year ago where it was $12.4 billion. We added 28 net dealers in the U.S. and now have a market share of 29.4% of U.S. wholesale business.

And finally, on my part, a slide about China joint ventures. Our China joint ventures were more directly impacted by economic shutdowns due to the earlier spread of the virus in China. Our retail originations, as well as ending earnings assets, were both down compared to the fourth quarter of 2019 and the levels of a year ago. Our penetration of both SGM and SGMW retail sales, however, was up in the quarter. Charge-offs also increased compared to the fourth quarter 2019 and the first quarter a year ago, but we do expect charge-offs to normalize as we go out through the remainder of 2020. And finally, our equity income was impacted by lower origination levels as well as increasing charge-offs and is down both year-over-year and sequentially. Good news is that all of our employees have returned to the office with enhanced safety protocols in place, and virtually all of our dealers are open in China.

And with that, I'll turn it over to Susan.

Susan B. Sheffield ***General Motors Financial Company, Inc. - Executive VP & CFO***

Thank you, Dan. On Slide 14, the financial results. As Dan mentioned, our earnings before tax was $230 million, which was down from last year, largely due to an increase in the provision for loan losses related to the current economic environment. I'll address the provision in more detail later in my remarks. The increase in provision, however, was offset by higher lease income, net of depreciation expense and reduced interest expense. Our average outstanding debt declined almost 4% year-over-year. Our effective rate of interest on our debt was 40 basis points lower year-over-year. With respect to our outlook for 2020, earnings before tax will be lower than 2019 based on our current expectations for increased net charge-offs and lower used vehicle pricing, resulting in accelerated depreciation on our lease portfolio, both of which Dan discussed earlier.

Next, on Slide 15, I'll talk about the allowance for loan losses. Effective January 1, we adopted the new accounting standard for the allowance for loan losses, CECL, which requires the allowance for loan losses to cover the lifetime losses, including an input for economic forecast. We utilize a well-regarded third-party firm for economic forecast. On the slide that shows the walk in the allowance from the end of December to the end of March, you can see the day-1 impact to the existing portfolio at the end of the year, as we previously guided, was increased by $801 million. Then for the quarter, we increased the allowance another $40 million based on just the normal quarter activity, which is basically the net impact of charge-offs, net of recoveries and the volume originated and the credit mix of that volume, and of course, including the new input for economic forecast that the model requires.

We also received an updated economic forecast given the onset of the coronavirus outbreak which we ran through the model. Based on this updated forecast, we increased the allowance another $240 million, which is consistent with the annual net charge-off we increased to the 2% to 2.5% range that Dan mentioned. Our allowance for loan losses as a percent of ending receivables was 3.6% at 3/31/2020, up from 1.7% at year-end. The allowance for retail losses specifically was 4.4% at the end of March compared to 2% at the end of 2019. The allowance for loan losses on our commercial portfolio increased slightly from the end of 2019 due to the current economic forecast. With respect to the $291 million increase in provision expense year-over-year, the bulk of that increase is related to the $240 million that we built the allowance due to the current economic outlook.

Now let's turn to Slide 16 and talk about the balance sheet. Our ending earning assets were $96.1 billion at the end of March, which was relatively flat from December and down about $1 billion from March last year. The composition across the asset types was stable with loans comprising 57% of ending earning assets and our Latin America operations representing over 5.5% at the end of March. Given the current economic conditions, we did decide to bolster our cash position at the end of March by borrowing on our committed secured credit facilities. As a result, our debt was higher at the end of the quarter compared to December and a year ago. Because we borrowed more on our secured credit facilities during the quarter, unsecured debt as a percent of total funding decreased to 52%, down from 55% at the end of December but remains in line with our target of a 50-50 split between secured and unsecured funding. As the economic and funding markets evolve over the next several months, we may decide to pay down some of those facilities, converting a portion of our liquidity back to as eligible borrowing capacity. Our liquidity remained strong at quarter end at $24.9 billion with a higher proportion in cash for the reasons I just discussed. This level of liquidity is in line with our target of maintaining enough liquidity to support 6 months of net cash needs without access to the capital markets.

Moving on to the next slide. We wanted to provide an update of our asset and liability profile that we provided to you in mid-March. As you can see, very similar to the previous disclosure, about $20 billion in excess liquidity is generated.

Now turning to funding activity on Slide 18. We were very busy in the quarter, raising $3.4 billion across our 3 public securitization platforms, and we complemented this by $1.1 billion of private amortizing transactions for our prime loan and lease platform. And we raised $2.1 billion in senior unsecured note issuance. Subsequent to quarter end, we successfully issued the first prime loan ABS transaction in April, raising $800 million, and this ABS transaction was done without TALF support. TALF is the Federal Reserve's Term Asset-Backed Securities Loan Facility program, which was announced in March to support the ABS market. But again, we did not need to utilize that program. In addition, we closed 2 private ABS transactions with our bank partners supporting our lease platform since the end of the quarter. We ended the quarter with over $26 billion in committed credit facilities provided by 27 banks, and our banking partners remain supportive of our business.

Next, on Slide 19. Our public debt issuance plans are highlighted here and remain generally on track despite a more challenging environment. The amount we ultimately issue will depend on market conditions and the pace of origination volume. And just as a reminder, as we've said many times, we seek to fund our businesses locally, but we'll maintain flexibility to issue outside the U.S. to support the U.S. platform as it is the largest.

Next slide, 20. Our capital position remains solid. Our tangible net worth was $10.1 billion at March 31, down from December, due primarily to 3 factors. The first and the largest was the adoption of CECL, which I mentioned in my allowance remarks. This had a onetime tax effect impact to equity of $643 million. Second, we had about $543 million related to other comprehensive loss due to a stronger U.S. dollar. The biggest driver of these changes is in equity value of our foreign subsidiaries as we don't hedge our equity investments there. And third, the dividend that Dan mentioned that we paid to GM in March for $400 million. Our leverage ratio increased to 9.3x in the quarter and remains below our 10x managerial target. Our return on average tangible common equity was down due to a higher effective tax rate, which is really driven by the reduction in the electric vehicle tax credit. We remain on track to pay another $400 million dividend to GM this year, which takes into account our current and expected leverage ratio when considering our earnings and balance sheet size expectations.

Turning to our last slide, 21. Let's review our capital adequacy as it relates to the cushion we have with respect to the Support Agreement leverage ratio. Based on our current net ending earning assets of $94.1 billion, the Support Agreement leverage ratio metric is 11.5x. As a reminder, we ended the March quarter at 9.3x. The minimum required capital at 11.5x would be $8.1 billion. At our current tangible net worth of $10.1 billion, we have about $2 billion in capital cushion, which basically means that we could absorb a doubling of our current expectations for annual net charge-offs and used vehicle price declines that Dan described without capital from General Motors.

So in conclusion, these are unprecedented times indeed. GM Financial is well positioned to support our team members, our customers and our dealers. We're thankful for our team members' dedication. They have risen to the occasion, are demonstrating what being agile truly means, working hard in new ways and focused as always on providing an excellent experience serving our customers and dealers.

Thank you for your support and interest in GM Financial. I turn the call back over to Steve.

Stephen Jones ***General Motors Financial Company, Inc. - VP of IR***

Thank you, Susan. This concludes GM Financial's First Quarter 2020 Earnings Presentation. If you have questions, please feel free to contact me. As mentioned, my contact information can be found on both the earnings release and at the end of the presentation slides. Thank you for your continued interest and support of GM Financial. Have a nice day.