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EDITED TRANSCRIPT

ACF.N^J10 - Q3 2020 General Motors Financial Company Inc Earnings Call (Prerecorded)

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PRESENTATION

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

Welcome to GM Financial's Third 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 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 off with financial and operating highlights for our quarter ended September 30, 2020.

GM Financial had record earnings before taxes, primarily due to unusually strong used vehicle prices, reduced provision expense and lower interest expense.

Susan will go over the details of the quarter momentarily. Our total originations of $12.8 billion were higher than the $11.3 billion a year ago, driven by an increase in penetration levels to 42.6%, up from 36.7%.

Our ending earning assets were fairly stable at $96.5 billion, and our retail charge-offs decreased to 1.2% from 1.6% a year ago.

We obtained the #1 market share position for floorplan financing in the U.S. for GM dealers. As far as customer experience, we continue to maintain industry high loyalty rates and have very good Net Promoter Scores. We're leveraging AI-powered technology to reach nearly 50% of our customer contacts by chatbot.

Our funding platform remains active. We issued $9.9 billion in private and public debt securities and added or renewed six committed credit facilities totaling $2.9 billion. And during the quarter, we raised $500 million of cumulative perpetual preferred stock.

Next slide, I'll dive into retail loan originations and our portfolio balance. We originated $7.3 billion of loans in the third quarter, which was up from $5.4 billion a year ago but down sequentially from $8.7 billion in the second quarter of 2020.

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Our loan originations were driven primarily by changes in our penetration rates. You can see that the penetration for the third quarter of 2020 was 42.6%, up from a year ago, but down sequentially. I'll add that our penetration levels are driven largely by the incentive programs offered by General Motors. And in the third quarter, there was a pullback on the 0% financing offers, which were prevalent in the second quarter of 2020.

Retail loan credit performance. Net charge-offs and delinquency rates in the U.S. were better than pre-COVID expectations due to the ongoing effect of government support programs, a change in consumer spending behavior and the economies reopening in many of our markets.

Payment rates across all FICO tiers in the third quarter compared to a year ago were higher and favorable, including accounts we deferred immediately post pandemic.

Our outlook for 2020 credit is improved to be slightly lower than 2019 compared to our previous estimate of 2% to 2.5% due to the resilient credit patterns we've seen in the U.S. and better recovery rates on repossessed vehicles.

For 2021, our annual net charge-offs are expected to be a bit higher than 2020 due to ongoing effects of job losses on consumer credit.

Operating lease originations and portfolio balance. Our lease originations were $5.5 billion in the third quarter, about flat from a year ago, but up considerably from the second quarter of 2020.

Originations increased compared to the second quarter as dealerships reopened and end of term processing normalized in many of our major lease markets. The lease portfolio remains very high credit quality with FICOs in the 770s range and most of the loans being current as of the end of the quarter. The return rate on vehicles declined to 57% from the 70s in prior quarters, primarily since higher used vehicle prices drove customers to purchase the vehicle at the end of the lease versus returning it.

Next slide, GM Financial used vehicle trends. Used vehicle prices peaked in August, driven by lower new vehicle inventory and strong demand for used vehicles before beginning the seasonal decline in September and October. We took advantage of the strong market by holding off on selling lease inventory early in the pandemic and then selling large volumes in June, July and August, when prices were rising. Our off-lease inventories normalized by August, and so our selling cadence is now at regular levels.

Given record prices in the third quarter of 2020, used vehicle prices for the whole calendar year 2020 are now expected to be above 2019 levels in the low single-digit area.

For 2021, industry sources currently expect prices to be down in the mid-single-digit range compared to 2020 due to normalizing new vehicle inventory and rising vehicle supply from a greater level of trade-ins and normalized off-lease inventory return to the market.

Next slide, commercial lending. We continue to see steady growth in our penetration of dealers in the U.S.

As I said before, we now have reached the #1 share in the U.S. at 31.4%. Outstanding receivables, however, remained depressed at $8.5 billion compared to levels a year ago, primarily due to the manufacturing suspension immediately post COVID as well as subsequent robust demand for new vehicles.

Dealer health remained stable due to improving auto sales as well as profitability supported by high margins on both new and used vehicle sales.

In my final slide, China joint ventures. China was affected by the pandemic earlier than the rest of the world but also recovered quicker than most of our other markets. Origination volume for the third quarter of 2020 in our joint ventures was $3.4 billion, up a year ago and sequentially, leading to earning asset levels of $20.3 billion at the end of the quarter.

Credit metrics in China have returned to near-normal levels with charge-offs of 30 basis points equal to a year ago, but down from the small spike resulting from COVID.

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And finally, our profitability of the joint venture, our equity income has returned to normal levels as well with income of $47 million, up sequentially and from a year ago.

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

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

Thank you, Dan. Turning to Slide 10. As Dan mentioned, we had a record quarter with $1.2 billion in pretax income, an increase over the previous quarterly record of $711 million a year ago.

Let's take a look at what drove the increase. First of all, from a revenue standpoint, total revenue was down, driven by the lower commercial lending and lease balances that Dan referred to.

However, our retail loan balance grew due to the higher penetration levels, and that drove finance charge income on our retail portfolio up $64 million year-over-year.

Moving on to leased vehicle expense. You can see leased vehicle expense was down $448 million year-over-year, and that was largely driven by the strong used vehicle prices, resulting in lease termination gains of $426 million.

Turning to loan provision expense. This was also better in the quarter, driven again by strong used vehicle prices, which changed our forecasted outlook for recovery rates on the loan portfolio. Also, better credit performance in the period resulted in lower provision expense year-over-year. I will note, so when we're looking at provision for loan losses as well as the allowance, it's really not comparable year-over-year due to the new accounting methodology for allowance for loan losses and the implementation of CECL.

So I just want to caution everybody to comparisons there. We'll talk about the allowance and provision a little bit more in a minute.

The last main driver for the beat was related to interest expense. The effective rate of interest on our debt was down 80 basis points year-over-year due to the decline in benchmark rates, and our average outstanding debt was relatively flat compared to 2019.

Now let's turn to the nine months ended September and look at the drivers for performance there. Earnings before tax year-to-date ended September -- for the nine months ended September is ahead about $57 million from last year, really largely driven by leased vehicle expenses being lower, again, due to strong used vehicle prices, driving lease termination gains for the nine months, that was $381 million. And again, interest expense being lower by $446 million, again, due to the declining benchmark interest rates.

These 2 things largely offset the -- or did offset the increase in provision for loan losses for the nine months. So again, we did increase our reserves due to the onset of the pandemic and the slightly higher volume that we had in Q2. And then total revenue was also down for the reasons we talked about with respect to the 3-month comparison.

Turning to the allowance on Slide 12. Just as a reminder, and I mentioned it earlier. At the beginning of the year, we implemented CECL, which is the new loan allowance methodology. There are two major differences. And I mention these again because this is why it isn't comparable year-over-year, and it will be beginning in 2021 but not as it relates to comparing to 2019. And those two differences are under the CECL methodology, we must reserve for expected lifetime losses rather than incurred losses, and also CECL incorporates an economic forecast over the reasonable life of the portfolio.

So turning -- again, you can see the allowance came down from 4.4% in June to 4%, and that was really largely driven by lower provision expense. And again, as I mentioned, that was a result of a change in the outlook for recovery rates over the forecasted period, slightly improving compared to our previous outlook.

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Now turning to the balance sheet and capital. Our earning assets at September 30, 2020 totaled $96.5 billion, down from a year ago due to reduced commercial and lease portfolios for the reasons Dan discussed. This was offset somewhat by robust retail loan origination volume, which began in Q2 and ending earning assets are up from $94 billion at the end of the June quarter.

Retail loans are now 50% of ending earning assets compared to 43% a year ago. Total debt is $89 billion and unsecured debt as a percentage of the total increased to 60%, well above our target of 50%.

With respect to available liquidity. Available liquidity was $29.1 billion at quarter end, above our target liquidity metric of maintaining six months' worth of liquidity to support all obligations, including originations and debt obligations.

The capital markets continue to be supportive of GM Financial and overall market liquidity remains robust. I'll talk about our funding activity during the quarter in a moment. Turning to Slide 14. Our capital position remains strong with $11.4 billion of tangible equity. Year-to-date earnings and our preferred stock issuance in September largely offset the impacts to equity from the implementation of CECL at the beginning of the year, foreign exchange headwinds due to a stronger dollar with respect to our non-U.S. subsidiaries, and the dividend payments to GM.

Our leverage ratio at the end of September was 8.38x and below our managerial target of 10x. GMF has a capital cushion of more than $3 billion to absorb losses through significant deterioration of used vehicle prices and/or credit losses before exceeding the Support Agreement leverage ratio limit, which is currently set at 11.5x.

Another important metric is our return on average tangible common equity, which was 16.4% for the four quarters ended September 30, 2020, and at the high end of our target range of a low mid- -- low to mid-teens percentage.

Now let's look at our funding activity during the quarter on Slide 15. We continue to have strong support from our bank partners with access to committed credit facilities of roughly $26 billion provided by more than two dozen banks.

We were very active in the third quarter, raising $4.8 billion in public asset-backed securities across our U.S. subprime loan, prime loan, lease and floorplan platforms. We also closed four private amortizing transactions to augment the funding needs of our U.S. lease and prime loan portfolios for a total of $2.6 billion closed in the quarter.

We issued $2.5 billion in fixed rate senior unsecured notes in the U.S. across three tenors, including $350 million of additional issuance of the 2030 Notes we originally issued back in June.

In September, we raised $500 million in the Series C preferred stock, and this basically rounded out our objective of raising a total of $2 billion in this part of the capital structure since inception of the program in September of 2017. So it's been busy this year in the capital markets, and our funding activities are substantially complete.

However, having said that, we always remain flexible on additional issuance to round out the year, which will be dependent on market conditions and future asset origination levels.

In conclusion, our September quarter 2020 was very strong with pretax earnings of $1.2 billion, origination volume up year-over-year, driven by higher retail penetration and strong dealer engagement.

Credit and residual results outperformed, and our capital position can weather significant increases to current expectations of consumer credit losses and deterioration in used vehicle prices and the capital markets continue to be supportive.

Finally and very importantly, a huge thank you to the GMF team members who continue to be highly productive and effective and are very -- in this very unique environment.

Thank you, and everyone stay safe and healthy. I'll turn the call back over to Steve.

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

Thank you, Susan. This concludes GM Financial's Third 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.

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