2Q15 Prepared Remarks

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This presentation includes certain non-GAAP financial measures. These non-GAAP financial measures are in addition to, and not a substitute for or superior to, financial measures prepared in accordance with GAAP. See the end of our press release filed today on Form 8-K reporting our 2015 first quarter results for a reconciliation of the non-GAAP measures used in these remarks to their most directly comparable GAAP measures.

James Samford – Head of Investor Relations

Good afternoon, and welcome to Lending Club's first quarter of 2015 earnings conference call. Joining me today to talk about our results are Renaud Laplanche, Founder and CEO; and Carrie Dolan, CFO.

Renaud Laplanche – Founder and Chief Executive Officer

Introduction
Welcome to our second quarter conference call.

This was another great quarter. We generated operating revenue growth of 98% year over year, accelerating from 17% quarter over quarter in Q1 to 19% in Q2, faster than our initial plan as we saw opportunities to efficiently accelerate as the quarter developed. Given the strong momentum we are seeing in our core business and the progress we are making in our new business initiatives, we have again decided to raise both our revenue and EBITDA outlook for the year on a dollar and percentage basis.

I'll begin today's call with our second quarter results and progress on key initiatives, then will talk about repeat customers and investor mix, discuss the regulatory framework we operate in and talk about an addition we are making to our executive team. I will then turn the call over to Carrie for more details on our financial results, third quarter guidance and an updated full year outlook. At that point we'll turn the call over to the operator for questions.

Let's get started.

Q2 Highlights

Originations
Starting with originations…

- Loan originations in the second quarter increased 90% year over year to $1.91 billion, compared to $1.0 billion in the same period last year. Since we closed the Springstone acquisition on April 17 last year, this quarter was our first quarter reporting year-over-year growth on a fully comparable basis. About $11.2 billion in consumer and small business loans have now been issued through our platform since we launched over eight years ago, including $6.1 billion just in the last twelve months.

- Currently, our marketplace remains neither supply nor demand constrained.

- We set our growth plans each quarter in a way that optimizes for long term shareholder value creation, for delivering a great user experience that helps build customer satisfaction and the long term value of our brand, and for managing risks and operating efficiency. As the quarter progressed, we saw that internal and external conditions supported a faster growth than initially planned and took that opportunity.

Revenues
As I mentioned in introduction, operating revenue in the second quarter jumped 98% year over year to $96 million, with growth accelerating quarter over quarter from 17% sequential growth in Q1 to 19% in Q2.

Adjusted EBITDA
Adjusted EBITDA in the second quarter was $13.4 million, up 235% year over year. Margins expanded sequentially from 13.1% in Q1 to 13.9% in Q2 despite a continued aggressive investment in engineering and product development designed to fuel long term growth, increase operating efficiency and deliver a great user experience, as well as aggressive investments in back office and risk management functions to continue to de-risk future growth.

Other Highlights from the Quarter
Now let me turn to our progress towards key initiatives and other highlights from the quarter.

- First, an update on our marketing channels
  - In our core personal loan business we continued to diversify our marketing channels with new low cost channels providing additional marketing efficiency, as well as benefit from marginally lower acquisition costs across the board with sales and marketing expense as a percent of origination dropping from 2.04% in Q1 to 2.01% in Q2.
    The network effects we have benefited from in the past continue to manifest themselves and in Q2 we saw further efficiency gains particularly in our core personal loan product, including higher conversion rates and improving funnel efficiency. We have not seen this quarter the negative impact of increased competition.
  - We also expanded our addressable geographic market over the quarter and post quarter end, with the addition of two states on the borrower side and five states on the investor side.
  - Education and Patient Finance continued to be an area of investment for us in Q2 with the expansion of our field sales team, which is generating strong momentum. In fact our Education and Patient Finance originations and revenue grew faster sequentially than the rest of the business, in percentage terms, for the first time in the second quarter.
  - In small business, we have several key partnerships launching this quarter, and we signed a series of new partnerships in Q2 including an alliance with Ingram Micro, the world's largest wholesale technology distribution company, to be the exclusive provider of unsecured lines of credit and term loans up to $300,000 for their tens of thousands of U.S. value added resellers. We also signed an exclusive partnership with Zulily, an online specialty retailer, to make financing available to their online merchants. We believe that our scale, brand and reputation continue to help us secure the most sought-after partnerships in the industry, and our superior technology architecture enables us to efficiently launch deeply integrated partnerships.
  - In terms of new channel testing, in Q2 we completed several direct response radio and TV test ad campaigns and have been pleased with the lift in some of the test markets. We will continue to test and iterate on messaging, media channel and programming to try and generate a predictable and consistent lift across test markets before expanding this program more broadly, but I would say we have learned a lot in a short time and the early results are encouraging.
- Custom Programs Share of Origination

- Finally we continued to make progress across all custom programs (which include small business and education and patient finance), with marketing, distribution, pricing and credit model improvements that helped drive 33% sequential growth in these programs in the second quarter.

- ***One-time Disclosures***

Now we are making 2 one-time disclosures this quarter that we hope you will find useful to understand long term trends in the business. The first is about repeat customers, both on the investor and borrower side, and the second relates to the investor mix and how that mix helped drive interest rates down over the last couple of years.

Repeat Customers

- We released last quarter some data on customer satisfaction and Net Promoter Score. The very high satisfaction rates we have earned from our borrower base translate into a high propensity to do business with us again. This quarter we have included in the quarterly earnings presentation available on our Website a few slides on repeat customer trends for both investors and borrowers.

- On the investor side, repeat investment and increased account size are key measures of satisfaction.

- We have included a slide showing retail investor account size by vintage. Our self-directed retail investor base surpassed 100,000 active accounts for the first time this quarter, including many investors who consistently add to their account and reinvested the principal and interest payments they receive. You will notice that the average initial account opening value, as well as the pace of growth of the average account size, has increased with each vintage. The most recent annual vintage of 2014 is now showing an average account size well over $15,000 at the one-year mark.

- Individual investors represent 70% of the $1.45 billion invested in our standard program loans in Q2. This was a milestone quarter with our first $1 billion quarter contributed by individual investors. As we expand geographically and open to investors in new states, we expect to see this loyal investor base continue to represent a stable source of capital. We believe that new and repeat investments are clear indicators of investor engagement and satisfaction with our platform.

- On the borrower side, we are reporting this quarter repeat borrower rates both by vintage and as a % of our total customer base. Once the first loan is paid off or substantially amortized, roughly 27% of our borrowers come back to Lending Club and obtain a second loan within four years of obtaining their first loan, despite stringent restrictions from a credit policy standpoint. This rate of repeat customers has accelerated over time much as we saw on the investor side as we have continued to improve the customer experience and level of satisfaction, with the 3-year repeat rate approaching 30% in our most recent vintages. We believe substantial value remains to be unlocked from our existing customer base, with only 14% of the current base of nearly 1 million borrowers having returned for a second loan. Because of our rapid growth, the average age of our core personal loan borrower base remains very young at roughly 1.3 years, with roughly 80% of our borrowers having received their first Lending Club loan in just the last 2 years. Over time, as the age of the borrower base increases, and as we add new use cases and new products, we would expect the repeat borrower trends and cross sell opportunities to continue to increase both on a vintage and overall basis.

- From a credit standpoint, our platform applies stringent controls over the ability to take a second loan with the application of the same credit checks and credit parameters as the first loan, augmented with additional obligations to have made at least 6 to 12 months of on-time payments on the first loan depending on credit quality. We take great care to monitor this repeat population and their performance trends in order to deliver consistent and predictable returns to investors on the platform.

- We have also provided in our quarterly earnings presentation high level unit economics for the first and second loan. The simple illustration highlights that there is effectively no sales and marketing cost for repeat borrowers and therefore, on a blended basis, we expect to see contribution margin in the 80s for the second loan, driving the average contribution margin in the 60s for repeat borrowers, as compared to 45% for the business overall.

- As we continue to expand use cases and offer new products, this trend represents an important tailwind for customer engagement, cost efficient origination growth, and contribution margin leverage.

- Now turning to Investor Mix & Average Yield

- The investor mix for the standard program in Q2 was 20% self-directed individual investors, 50% individual investors investing through a fund or managed account and 30% institutional investors.

- Our diversified institutional investor base which includes foundations, endowments, insurance companies, banks, finance companies, asset management firms and corporate pension funds continues to provide our platform with the flexibility to broaden the scope of our originations and expand our credit offering into very high credit quality Super Prime loans as well as lower credit quality in near prime.
    - A key driver of our network effect comes from the amount of data we have been collecting over the last 8 years and our track record of delivering consistent returns, which we believe increases investor confidence and lowers the risk premiums required by investors. This enables our platform to deliver lower interest rates to borrowers, which drives positive selection, increases loan performance and further reinforces our track record.
    - As a result, the risk premium on the Lending Club platform, as measured by the spread over 3-year treasuries, came down by 270 bps over the last 3 years.
    - Our ability to lower interest rate to borrowers came both from the existing investor base being willing to accept a lower yield and new, more conservative investors growing their participation on our platform: year to date, roughly 20% of the loans on our personal loan platform were invested in by banks and finance companies, generally more satisfied with lower yields than other types of institutional investors.
    - Our platform also benefits from investments from more aggressive institutions including asset managers with appetite for our custom programs.

Regulatory Update

Next let me say a few words about the regulatory framework we operate in:

- Our marketplace benefits from what we believe to be an efficient regulatory framework that offers borrowers the same level of consumer protection they benefit from a bank, while providing us with more flexibility, and a more cost-efficient and capital-light framework.

- In particular all loans are overseen, issued and originated by federally regulated banks, and all federal lending regulations including truth in lending, fair lending, fair credit reporting are applicable. We believe that one of the benefits of our platform is to use technology to make consumer protection more effective and more efficient.

- As an alternative to our partnerships with issuing banks, another framework available to us is a direct lending approach, by utilizing state licenses. Under a state license framework, however, interest rates would be limited by state-specific interest rate caps and, based on our current mix, we estimate that roughly 12.5% of our platform's loan volume would exceed the interest rate caps in certain states.

- Another key aspect of our regulatory framework is that we do not collect deposits like a bank would; instead we sell securities or whole loans to investors and these securities are matched in terms of rate and duration with the underlying loans. As a matter of business model, Lending Club does not assume credit risk or interest rate risk, which are borne by investors. Therefore there is no capital reserve requirement or FDIC insurance.

- Over the last 8 years we have been in regular dialogue with regulators at the federal and state level and we are encouraged by the constructive discussions we're having. In general we believe regulators recognize the benefit of our business practices and our ability to make credit more affordable and transparent to consumers. As an example, CFPB Director Richard Cordray declared in an Associated Press interview released on July 31st, when asked about marketplace lending that "so far it's been a pretty consumer friendly industry. We'll see how it develops". We intend to continue to pull the industry toward more transparency and better terms for consumers.

- In another recent development the Department of the Treasury recently sought public comments on "online marketplace lending and expanding access to credit", which we very much welcome and support. The request for comments is aimed at evaluating the potential for online marketplace lending to expand access to safe and affordable credit for consumers and businesses and how the financial regulatory framework should evolve to support the safe growth of the industry.

- We commend this initiative from the Treasury for setting up a transparent and open process, which we believe will help raise awareness and understanding for the current regulatory framework, for our consumer friendly and transparent business practices, and provide further support for Lending Club's ability to safely grow into a very large online marketplace that will make credit more available and more affordable to consumers and small business owners.

New Chief Credit Officer

Now before turning the call over to Carrie, I would like to share the good news that Sandeep Bhandari will be joining Lending Club as our new Chief Credit Officer on August 24.

We're excited to welcome Sandeep as a key member of the executive team. He joins us after 15 years at Capital One, where he was most recently Assistant Chief Credit Officer at Capital One Bank. Prior to that Sandeep held a variety of roles requiring expertise in strategy, credit risk management, marketing, product development, and underwriting across several lines of business including consumer and small business credit card, auto lending, and mortgage and home equity lending.

Chaomei Chen will be retiring later this year after ensuring a transition period. We're grateful to Chaomei for the formative role she has played over the last four years in establishing the foundation for, and building, a remarkable credit and risk management organization, and wish her the best as she begins a new chapter of her life.

Now let me turn the call over to Carrie to go into more detail about our financial results, our guidance for the third quarter, and an update on our full year outlook.

Carrie Dolan – Chief Financial officer

Intro

Thanks, Renaud.

- This was another outstanding quarter with financial results that topped our initial outlook thanks to a combination of incrementally faster growth and a couple positive drivers.
- I will first review our financial results and then review our third quarter and annual guidance before taking your questions.
- All year over year comments are comparisons to the second quarter in the prior year.

Originations / Revenue

- As Renaud shared, total Originations in the second quarter grew to a record $1.9 billion, an increase of 90% compared to the same period last year. This origination growth drove equally strong revenue growth. Operating Revenue in the second quarter was $96.1 million, up 98% year over year.
- As a reminder, the majority of our revenue is earned in 2 ways:
    - First, transaction fees are earned up front when a loan is originated. These fees totaled $85.7 million, up 87% year over year and represented roughly 89% of operating revenues in the second quarter.
    - Second, servicing and management fees from investors are earned over the life of the investments. During the second quarter, these fees totaled $9.0 million, up 208% from last year.

- Second quarter revenue performance came in ahead of our outlook as a result of several drivers.
    1. First, we continued to see favorable marketing efficiency in our standard personal loan product.
    2. Second, we saw positive momentum in our custom programs, which includes custom personal loans, Education and Patient Finance and Small Business. Custom program originations grew 33% quarter over quarter and represented 24% of our second quarter originations, compared to 21% last quarter.
    3. Third, we continued to see favorable investor mix this quarter with demand coming from investors who pay marginally higher servicing fees.

Revenue Yield

- Our revenue yield, which is operating revenue as a percent of originations, was 5.03%, up 7 basis points sequentially and 20 basis points year over year.
- Servicing and Management fees accounted for 17 bps of the increase.
    - The servicing line includes adjustments for our servicing liability for loans that we have sold but continue to service. Last year, we made a one-time accounting adjustment, which drove most of the 9 bp year over year increase.
    - Higher collection fees drove 5 bps of the increase and the remaining 3 basis point improvement was split between higher servicing fees and a change in fee mix.

- Other revenue also increased year over year, moving 9 bps higher driven by gains on sale associated with selling whole loans.
- These increases were partially offset by a 7 basis point decline in transaction fees due to a greater mix of the education and patient finance "true-no interest" product which was launched in late 2014 and has inherently lower revenue yield.

- On a sequential quarter over quarter basis, we saw improving revenue yield across all products.

Expenses / Contribution Margin

- Now turning to expenses.
- We divide expenses into 2 major buckets: those that directly drive revenue and are part of our contribution margin, and those that support our infrastructure and long term growth.
- As we review expenses in this section, please note that these amounts exclude stock based compensation, depreciation, amortization, and acquisition-related expenses.
- The contribution margin expenses that directly generate revenue include: Sales and Marketing, and Origination and Servicing.

Sales and Marketing

- Sales and Marketing expenses consist primarily of those related to borrower and investor acquisition and activation, as well as overall brand building. They vary quarter to quarter with seasonality, channel mix, channel testing, and additional marketing efforts designed to support new product launches.
- In the second quarter, Sales and Marketing expenses were $38.5 million, up from $18.6 million a year ago. As a % of originations, sales and marketing expenses decreased from 2.04% to 2.01% sequentially quarter over quarter and increased from 1.85% to 2.01% year over year.
- The year over year increase is the result of continued efficiency gains in our personal loan core business, offset by marketing investments in the newer businesses and channels and expense reclassification:
    - As we highlighted in the last quarter, we reclassified our personal loan sales team costs from the Origination and Servicing line into the Sales and Marketing line. Excluding this reclassification, our sales and marketing expenses as a % of originations would have been 1.95% in the second quarter, up 10 bps from the prior year.
    - Network effects and scale continued to play in our favor with respect to our personal loan core business, driving sales and marketing expenses in our core business down 5 bps year over year. This improvement was offset by 15 bps of year over year increase in education and patient finance and small business products as we continue to invest in building up our sales team and developing scale in new marketing channels.

Origination and Servicing

- Our Origination and Servicing expense consists primarily of personnel related expenses for credit, collections, customer support, and payment processing teams and vendor costs associated with facilitating and servicing loans such as issuing bank, and credit agency fees.
- In the second quarter, Origination and Servicing expenses were $14.4 million, up from $8.1 million last year. As a % of originations, these expenses increased 2 basis points sequentially from 73 to 75 basis points, and declined 5 basis points from 80 basis points to 75 basis points year over year.
- Excluding the 6 bps reclassification, Origination and Servicing expenses would have been 1 basis point higher year over year with 3 bps improvement in our core personal loan product offset by less efficiency in Small Business and Education and Patient Finance.
- Small business and education and patient finance also drove the sequential quarterly increase.

Contribution Margin

- Both Sales and Marketing and Origination and Servicing expenses are netted against our operating revenue to derive contribution income and a Contribution Margin, which focuses on the efficiency of how we drive our revenue.
- On a dollar basis, our contribution income in the second quarter was $43.2 million, up 97% year over year.
- As a % of originations, our contribution margin expanded 8 basis points from 2.18% to 2.26% year over year driven by 20 basis point improvement from higher revenue yield, offset by 12 basis points of higher expenses driven by our newer products.
- As a percent of operating revenues, our contribution margin was 44.9% in the second quarter, down slightly from 45.1% in the prior year and up from 44.1% in the prior quarter.

Operating Expenses / EBITDA

- The second set of expenses that are outside of our contribution margin but are included in our adjusted EBITDA margin are costs that support our infrastructure and long term growth. Specifically, these are engineering, product development and other G&A costs.
- Engineering and product development expenses include personnel related costs along with non-capitalized hardware and software costs.
- We continue to aggressively build our engineering team to develop new products that will fuel future growth and drive automation, and to increase scalability and information security ahead of growth.
- As a result, engineering and product development expense increased to $10.4 million in the second quarter, up 82% year over year.
- As a % of operating revenues, engineering and product development expenses were 10.8% in the second quarter of 2015, down from 11.7% last year.

- Other G&A includes personnel related expenses for our support organizations such as legal, finance, internal audit, accounting, risk management and human resources, along with facilities expense.
- Year over year, these expenses increased to $19.4 million in the second quarter, up 59%. While we continue to invest in these support teams to further accommodate and de-risk future growth, we generated strong leverage in these areas during the quarter.
- As a % of operating revenues, other G&A expenses were 20.2% in the second quarter, down from 25.2% last year.

EBITDA

- To derive our adjusted EBITDA, we subtract these operating expenses from our contribution income.
- In this quarter, adjusted EBITDA was $13.4 million or 13.9% of revenue compared to $4.0 million or 8.2% of revenue in the second quarter last year.
- Adjusted EBITDA came in ahead of our second quarter guidance range mainly driven by higher revenues and improved G&A leverage.

Adjusted EPS / GAAP

- Adjusted net income, which is GAAP net income excluding stock based compensation, and acquisition related expenses, was $10.3 million or 3 cents per diluted share during the second quarter versus $2.3 million, or a penny per diluted share in the year-ago period.
- Our GAAP net loss this quarter was $4.1 million compared to a loss of $9.2 million a year ago. The difference between GAAP and Adjusted net income is largely due to stock based compensation which increased $4.2 million year over year or 50% to $12.5 million.
- Meanwhile, stock based compensation as a % of operating revenue declined from 17.3% last year to 12.9% this quarter.

Balance Sheet

- Now turning to the balance sheet.
- As we have discussed, in contrast to the traditional banking system, capital to invest in loans is provided from loan sales and securities issued to investors rather than from banking deposits. A key differentiator for our marketplace model is that, as a matter of business model, we do not assume credit risk or use our own balance sheet to invest in loans, and the loan sales and securities issued to investors perfectly match the term of the loans.
- When reviewing our balance sheet, you will see both the loans as an asset and the corresponding notes or certificates as the offsetting liability. The changes in value of these loans, notes and certificates generally offset one another and do not impact our equity.
- At the end of March, total balance sheet assets reached $4.8 billion. Of this, $3.6 billion is in loans, $888 million is in cash and securities available for sale and the remaining $258 million in other assets.
- Our servicing portfolio, which includes both loans on the balance sheet and sold loans, increased to $6.5 billion in the second quarter, up from $5.6 billion in the prior quarter and $3.3 billion in Q2 last year.

Guidance

With that, let me give you our thoughts about the third quarter and fiscal year 2015.

- Given the strong performance we continue to see on many fronts, we remain encouraged that our strategy of fast yet disciplined growth is paying off and continues to de-risk future results. As such, we feel confident in once again raising our full year revenue and EBITDA guidance ranges.
- We expect operating revenue to be in the range of $106 to $108 million in the third quarter.
- We are also raising our full year outlook to a range of $405 to $409 million, up from a range of $385 to $392 million provided during our first quarter earnings call.
- As we have shared, our focus is to optimize long term contribution and adjusted EBITDA margins, and eventually net income; however, over the short term, we will continue to invest in key areas such as channel development, product development, engineering, process automation, support and risk management functions.
- In addition, there is seasonality in the business that we expect will lower our marketing and sales efficiency in the fourth quarter.
- With that in mind, we expect third quarter Adjusted EBITDA in the range of $12 to $14 million, with a midpoint margin of 12.1% and for the full year, we are increasing our range to $49 to $53 million, with a midpoint margin of 12.5%.

With that, let's turn to your questions. Operator?