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CORPORATE PARTICIPANTS

Newton G. Z. Glassman
Executive Chairman & Chief Executive Officer, Callidus Capital Corp.

Dan Nohdomi
Chief Financial Officer & Vice President, Callidus Capital Corp.

David M. Reese
President and Chief Operating Officer, Callidus Capital Corp.

OTHER PARTICIPANTS

Stephen Boland
Analyst, GMP Securities LP

Scott Chan
Analyst, Canaccord Genuity Corp.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, my name is Chris, and I'm your conference operator today. Welcome everyone to the Callidus Capital Corporation First Quarter 2016 Results Conference Call. At this time, all lines are in listen-only mode. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

Listeners are reminded that portions of today's call and of today's discussions, including responses to questions posed in today's call, constitute forward-looking statements that are subject to risks and uncertainties related to the company's future financial or business performance and condition. Actual results could differ materially from those anticipated in these forward-looking statements. Risk factors that may affect results are detailed in the company's filings with the Canadian Securities Regulatory Authority, which can be accessed at www.sedar.com.

Please note that the company is under no obligation to update any forward-looking statements discussed today, except as required by applicable law. And investors are cautioned not to place undue reliance on these statements.

On the call with us today from Callidus are Newton Glassman, Executive Chairman and Chief Executive Officer; David Reese, President and Chief Operating Officer; Dan Nohdomi, Chief Financial Officer; Jim Riley, Secretary; and Paula Myson, Vice President, Investor Relations and Special Projects.

At this time, I'd like to turn the call over to Mr. Glassman. Please go ahead, sir.

Newton G. Z. Glassman
Executive Chairman & Chief Executive Officer, Callidus Capital Corp.

Thank you, and good morning to everybody. I apologize in advance for my laryngitis. Thank you for joining us for our first quarter 2016 results call. During the call, we'll be referring to information provided in the financial statements and the MD&A and the associated news release for the quarter, all are available on our website and on SEDAR. As always, we appreciate your feedback on our materials, so please feel free to communicate directly with any member of the Callidus management team mentioned early – earlier.

You may have noticed from the introductions at the start of our call or from our website that we have added a new senior member to our management team at Callidus. Paula Myson, who joined us a few weeks ago and is today participating in her first results call with us. Paula is a CFA charterholder and has extensive experience in finance, operations and capital markets. She will be helping the Street better understand the nature of our business, and in particular, our strong potential for creating value for shareholders. Please feel free to direct your enquiries to Paula.

We'll keep our comments brief to allow for ample time for Q&A. David and Dan will provide you with some insight into the details of the operating and financial results for the quarter. But to begin, I'd like to comment on two initiatives of strategic significance during the last few months. The first relates to the new step taken to actively address the material disconnect between our performance and the performance of Callidus shares in the public market. We have stated many times that we've undertaken a four-step process to address the disconnect.

Step one was a normal course issuer bid launched in 2015 and which expires in May of this year, in which we acquired and cancelled approximately 2.6 million shares. Step two was the initiation of a dividend in August of 2015. The dividend rate was CAD 0.70 per common share per year. We also implemented and associated dividend reinvestment plan. We initially paid the dividend quarterly, but we have now changed the payment frequency to monthly. Step three was the initial – was the substantial issuer bid, we initiated last month and discussed with you on our last call. Under the SIB, the company is offering to purchase and cancel up to approximately 3.57 million common shares at a price of CAD 14 per share. The SIB price has a 36% premium over the March 29 closing price, the day before the SIB was announced, and a 53% premium over the volume weighted average of the 20 days preceding the announcement.

Catalyst Capital Group, which manages funds and owns 62% of the common shares outstanding, has advised Callidus that it will not tender any of its holdings to the CAD 14 SIB offer. As part of the SIB, the board took the unusual step of retaining National Bank Financial to conduct an independent formal valuation of the common shares. NBF's conclusion was that as of April 22, 2016, the fair market value of the Callidus shares was in the range of CAD 18 to CAD 22 per share, substantially and materially higher than the SIB price. The midpoint of this range, or CAD 20, is approximately a 43% premium to the SIB price.

Undertaking the SIB is potentially a CAD 50 million capital commitment for Callidus. With cash, available lines are remaining and actually the increases to that which we are going to talk about, and remaining loans of funding of capacity from Catalyst I, Catalyst V, we still have sufficient liquidity to grow our loan portfolio at an aggressive pace.

However, we have intentionally held the loan book constant at approximately CAD 1.2 billion, so as to maintain the ultimate flexibility and use of cash, post the expiry of the current SIB. We will continue to review the optimal use of cash to generate the maximum risk adjusted returns for all of our existing shareholders. As part of this, we will consider future normal course issuer bids, substantial issuer bids, accelerated or decelerated loan book growth or other usage of cash in the context of the best use and the best return, and for the benefit ultimately of our existing and continuing shareholders.

We have stated many times that we deal in a market segment where our clients often go through structural changes. As result, it is not uncommon for our clients to need or desire changes through the original deal with

Callidus. When such changes, known as accommodations, are requested or needed, Callidus may accommodate to borrow and exchange for a change in the economic relationship.

To this end, this quarter, we significantly advanced what we call yield enhancement options, in our loan portfolio, although such will not be seen in our financial performance metrics until we report Q2 2016. National Bank Financial's valuation included in the SIB put a value of $0.50 to a $1 per share on these yield enhancement options. It is management's belief that this is a conservative estimate.

Yield enhancement auctions often take many forms. The most commonly understood would include revenue royalty streams, periodic fee arrangements, warrants, equity options and limited equity participations to name just a few. We've already agreed to terms for the "yield enhancement options" pertaining to seven of the loans in our portfolio and expect to finalize agreements on an additional three loans next quarter.

We provided a description and a summary in our MD&A to help people further understand this yield enhancing issue. Next quarter, we'll expand the reporting to include more detailed information including, we hope, valuation regarding these participations, which we have undertaken.

I'll now ask David to walk us through the operating results for the first quarter.

David M. Reese

President and Chief Operating Officer, Callidus Capital Corp.

Thanks, Newton. We're pleased that the first quarter continued our overall longer-term trend of consistent improvement, with gains in the key metrics of revenue, gross yield, net income and return on equity. As of yesterday, gross loans receivable before due recognition stood at $1.17 billion, which is down slightly about 4% than where we closed out year end. The biggest impact came from the loan repayments. During the quarter, four loans were fully repaid for a total of $105 million. As Newton said, notwithstanding a very robust and high-quality pipeline, this was an intentional decision in Q1 to preserve cash and will likely continue until the completion of the SIB. Simply put, buying our stock at a 40-plus percent discount to the inherent value is a great risk-adjusted investment, and we remain committed to doing what is best for shareholders.

We have always talked about the growth of our loan portfolio in terms of years, namely doubling it every two years to three years. And in our first two years as a public company, we achieved this. What is important to recognize is that doubling may not always occur at a uniform pace. And in part, at times like this, when we feel the shares are below their intrinsic value, we feel compelled to take advantage of such for the benefit of all shareholders.

Please note that the pipeline has grown, and we expect the growth in the pipeline to continue given the market environment. We are therefore in a highly enviable position of being able to choose between two great options for the use of our cash.

Looking forward, and giving you some guidance on growth, the loan pipeline remains very strong at approximately CAD 980 million, including signed back term sheets and the balance of funding for Project Resolve of approximately CAD 210 million. On the repayment side, over the next few months, we anticipate four additional loan repayments, representing approximately CAD 171 million. Please note that the current signed back term sheets in the balance of funding for Project Resolve alone are more than sufficient for us to maintain the current gross loan receivable level.

On a separate note, namely credit quality, over the next quarter, we expect the resolution of about a third or 31% of CAD 124 million of gross loans receivable in our watch list account. I want to note that we consider loan repayments to be a critical part of our growth. Successful loan repayments demonstrate how working with Callidus our clients benefit from properly sized, designed and executed facilities that support the successful rehabilitation of their companies.

This helps future clients gain confidence in our capabilities, and the repayments provide us with capital to redeploy. We likely will restart growth of the loan book very shortly, as the stock price begins to realign with fair value, as reflected in the NBF valuation. And other uses of cash are less favorable.

Building on those resources, we also are pleased to announce that we've received commitments from two lenders in our senior revolving credit facility to increase the amount of that facility by $37.5 million. So, that facility will now stand at $337.5 million in total. Other terms of the facility remained unchanged.

Now, I'll ask Dan to discuss the financial highlights for the quarter. Dan?

Dan Nohdomi

Chief Financial Officer & Vice President, Callidus Capital Corp.

Thanks, David. Callidus recorded strong financial performance in the first quarter in a number of key areas that I will now highlight. Earnings per share were CAD 0.34, up 127% from CAD 0.15 last quarter and up 10% from $0.31 in the first quarter of 2015. Revenue after derecognition increased CAD 1.1million or 2% to CAD 49.5 million for the fourth – from the fourth quarter and was up 41% over the prior-year period.

Our consolidated gross yield for the quarter was strong at 19.4% compared to 17.9% in Q1 of 2015. Breaking that down, the gross yield by our two products, traditional Callidus loans and Callidus Lite, we earned 19.9% on our core product and 14.9% on our Callidus Lite loans. Both are up from Q1 2015, when we earned 19% on the Callidus loans and 14.8% on Callidus Lite.

ROE of 13.9% improved in Q1 of 2016 from 6.2% last quarter and from 13.6% in the first quarter from last year. Net income of CAD 17.1 million increased 125% from CAD 7.6 million last quarter and 7% in first quarter of 2015. Fourth quarter was impacted by atypical provision taken related to the Gray Aqua Group.

Our leverage ratio which is measured as net debt to gross loans was 38.9% at quarter end, down from 50.9% at the end of the prior quarter. The reason was that we realized in the loan guarantee during the quarter and applied the proceeds, principal and accrued interest to repay a portion of the subordinated bridge facility. The application of the guarantee proceeds, which was CAD 101.3 million bolstered our liquidity.

Our liquidity, and therefore capacity to fund new loans, has three components: cash on hand; the undrawn capacity in our senior debt and bridge facility; and further funding, which we obtained from loans from Catalyst Fund V. At the end of the quarter, total liquidity would be able to support approximately CAD 500 million of new loans. This leaves us in a very good position to capitalize on our growth opportunities that come from our robust pipeline.

To finish up on the future funding topic, we've mentioned on previous calls, we're engaged on – in discussions with a credit rating firm to rate the securitization. We are well advanced on those discussions and still expect to achieve an investment grade rating on the securitization structure. The rating will allow us to further diversify our sources of cost-effective capital to support loan growth and to further reduce our cost of debt. So, based on these key metrics our first quarter financial results extended our overall record strong performance.

David?

David M. Reese

President and Chief Operating Officer, Callidus Capital Corp.

Thanks, Dan. In the first quarter, our provision for loan losses was CAD 7.9 million, a ratio of 2.7% on an annualized basis. Risk is a typical and necessary part of our growing business. We will always approach it in a careful, controlled manner. Our target rate of provisions has historically been approximately 2% on an annualized basis. So, as you can see, we're currently running ahead of that rate. We are watching this metric carefully and expect to continue to be above it for a few more quarters closer to 2.5% to 3% on an annualized basis. We will continue to keep a close eye on this measure. And we'll take appropriate steps to manage the credit risk of our portfolio in a prudent manner.

With respect to the provision, many of you will recall the change in reporting that was introduced with IFRS. Under old GAAP, lenders have the ability to cease accruing interest on non-performing loans. IFRS prohibits this. What this means is that we continue to accrue interest at the original effective rate, and we will provide for this amount, should collectability be doubtful. Over half of this quarter's provision results from this concept. We expect that as assets are worked out as a normal part of our restructuring process, the interest component, and therefore, the entire provision will be reduced. This will occur over the next few quarters.

I also want to expand on the comments Dan made on the exercise of the guarantee during the quarter. We mentioned in our last call as well, but to recap, in March of this year, we exercised the guarantee on one of our loans, Xchange Technology Group. The exercise of this guarantee demonstrates the effectiveness of the Callidus business model.

Xchange has four businesses, which sell new and refurbished computer equipment as well as providing new equipments through short-term rentals. It was a loan that was brought into the portfolio as part of our IPO and was fully covered by the Callidus guarantee. The business was making progress and being restructured, but we felt the people at Catalyst had the most appropriate skill set to successfully advance this process. The rationale was that the recovery for Xchange would be accelerated by creating a direct interest for Catalyst, as it would dramatically increase their ability to directly influence the restructuring process.

Catalyst's expertise is to turnaround businesses, and they do this very well. Our businesses provide funding to our borrowers. So, we see increase in our liquidity and increase in the Catalyst influence on a Catalyst guaranteed turnaround asset as a win-win. We remain confident that our proven business model, strong credit quality and unique competitive position, and advantage in a favorable market environment will allow us to continue to record a strong positive result on behalf our shareholders in the future.

I'll turn it over to Newton for a final comment before we move to questions.

Newton G. Z. Glassman

Executive Chairman & Chief Executive Officer, Callidus Capital Corp.

Thanks, David. I'm quite satisfied with our first quarter results and even more pleased with our extended track record of solid and continuing improving performance over the longer-term horizon that concerns most investors, including our shareholders.

With our excellent credit quality, as sound as it has ever been; a growing pipeline of quality borrowers; the low-risk enhanced yield potential that I discussed earlier; and an unrelenting focus on our primary role of maintaining and improving our operating performance over longer multiple quarters, we continue to see nothing but a strong positive future for Callidus. As always, I would like to thank our investors for their continued support.

And now operator, we'd be pleased to take questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] The first question is from Stephen Boland with GMP Securities. Your line is open.

Stephen Boland
Analyst, GMP Securities LP

Q

Good morning, everyone. Just one question. I guess it comes down to the growth. And I understand the language that you intentionally slowed the growth this quarter. The repayments brought down your leverage. You have another CAD 171 million, I think, you said that's being repaid. And so just want to get a context of where you think the growth is going, because, certainly, it seems well laid out in the National Bank evaluation. I guess, their analysis of what loan repayments and income that you expect to generate over the next several years. So, I just want to make sure that there's nothing inconsistent with what was put in that valuation and what you're expecting?

Newton G. Z. Glassman
Executive Chairman & Chief Executive Officer, Callidus Capital Corp.

A

Good morning, Steve. We remain committed to doubling the loan book every two years to three years. When you look at our pipeline, which has over CAD 980 million in it, that's easily achieved by us. We decided to essentially hold the book at roughly CAD 1.2 billion and build up cash and liquidity, so that after the SIB, we can make the decision what the best use of the cash in the next step of our unlocking value for shareholders may be.

If we have a situation like currently where the SIB accretes more than 40% return on equity for the existing shareholders with no risk and no change in the book, we will compare that to the risk associated and the return in the growth. Typically we make 30-plus percent, 30-ish percent on a lever basis, but we also have execution risk in the new loans. Seems to me that the lowest-risk highest return is to use that cash up to and until the risk-adjusted return is better to execute on growth. Since we're continuing to grow the pipeline, we can turn on that growth, and we can accelerate that growth. And we're obviously continuing to work on those credits, as we're doing this so that we have them lined up.

We are going to wait and see how the stock performs after the SIB. If the SIB is not successful in closing the gap between the National Bank financial valuation, which we think is actually quite conservative, because it does not reflect the yield enhancement stuff to the full extent, and we've said that in our comments and for a bunch of other reasons. We'll evaluate the best use of that cash.

Growth is not the number one goal. Return on equity and value for the shareholders is the number one goal. We can restart growth at any time. And our duty is to the ongoing shareholders. So, I remain committed to the view that those that actually remain shareholders in this company will reap the greatest rewards, and we will get them the best returns by using our cash in the highest and best use on their behalf.

Stephen Boland
Analyst, GMP Securities LP

Q

Okay. That's all I had. I appreciate that comment, Newton.

Operator: [Operator Instructions] The next question is from Scott Chan with Canaccord. Your line is open.

Scott Chan
Analyst, Canaccord Genuity Corp.

Q

Good morning, guys. You talked about ROE targets. And it just seems with lower leverage and a lot slower growth this year. Has anything kind of changed to what your ROE targets over the next year – has anything changed to – in that respect just based on the current environment?

Newton G. Z. Glassman
Executive Chairman & Chief Executive Officer, Callidus Capital Corp.

A

So, two things. You're right, leverage came down. It came down for two reasons at the end of the quarter. The first and biggest reason was frankly that the exchange guarantee moving across to Catalyst reduced essentially 100%, CAD 1 dollar per CAD 1, which is about CAD 100 million of the bridge from Catalyst, which in turn, reduces leverage, which for a short period of time, will actually have impacted ROE.

I'm sure you didn't miss the fact that notwithstanding the reduced leverage at the end of the quarter, ROE was still up year-over-year and quarter-over-quarter. As we replace older loans with newer loans, so for example, the CAD 171 million that is coming due that we think will be repaid imminently, we will actually pull the leverage back up. It's one of the reasons why we've actually also indicated to people that the availability under the current facility has gone up by about CAD 37.5 million. That is to telegraph to everybody that it is a very short-term idiosyncratic issue about lower leverage, that leverage will bounce in the opposite direction.

The result of that is that ROE, that we continue to perform, should actually overcompensate for the short-term decrease in leverage, that's number one. Number two, as I said earlier, we can turn the growth back on whenever we want. So, we will turn it back on when the best rate of return risk-adjusted for the shareholders and then using the cash for growth. Seems to me that as a short-term indicator, ROE is exactly that. It's trying to show people where they're getting the best return. So, that means that we have to use the cash in the best way for the shareholders.

Sooner or later, when that growth goes back on combined with the increase in the facility that we've announced today as well as the imminent change in rating and the investment grade rating, which actually reduces our cost of debt. Sooner or later, we will meet or exceed those ROE targets, and we think it's pretty soon.

Scott Chan
Analyst, Canaccord Genuity Corp.

Q

And ROE targets in the high-teens plus the 20%, is that kind of what you're thinking?

Newton G. Z. Glassman
Executive Chairman & Chief Executive Officer, Callidus Capital Corp.

A

It's a very interesting issue. I've always said that I have the target north of 19% close to 20%, David always tells the Street that he says it's around 17.5% to 18.5%. We will be at David's target in the near future.

Scott Chan
Analyst, Canaccord Genuity Corp.

Q

Okay.

Newton G. Z. Glassman
Executive Chairman & Chief Executive Officer, Callidus Capital Corp.

A

And we expect to be at my target or else.

Scott Chan
Analyst, Canaccord Genuity Corp.

Q

Okay. And just on the yield enhancement that you've talked about. And appreciate the disclosure on seven loans [ph] and kind of these (24:05) enhancements, can you give me an example on how we should think about, as you said, like National Bank's valuation was conservative on. How should we think about these yield enhancements? Is it going to start later this year, potentially like – or I can't imagine it being immediate?

Newton G. Z. Glassman
Executive Chairman & Chief Executive Officer, Callidus Capital Corp.

A

Actually you should imagine it's immediate, it's quite a start hitting the P&L...

Scott Chan
Analyst, Canaccord Genuity Corp.

Q

Yeah.

Newton G. Z. Glassman
Executive Chairman & Chief Executive Officer, Callidus Capital Corp.

A

...in a very material way in Q2. So, the seven that we've closed essentially post Q1 will have a dramatic impact on earnings within this year and will start having a significant impact in Q2.

One of the reasons that I say that National Bank's valuation was conservative was because we've now incorporated in the business model a highly structured and disciplined way of approaching any borrower that comes to us for an accommodation. Our view is that the deal is the deal. It's inside the four corners of the document that we've singed with the company. Should the company want to change that deal, then we got to the change the deal. Anytime somebody now comes to us for an accommodation, we will evaluate that accommodation, and if we agree to it, we will be requesting something from them.

As a result, we will have a lot of borrowers because of their own positive or negative change in circumstance. They come to us, but they also come to us primarily because of the change in circumstance in the market. So for example, just to give you an example, let's say, a very good and very well-performing borrower is up for renewal. Auto loans are 364-day loans. They are required to repay us typically in 364 days. In this environment, getting refinanced with the Sched I banks is very, very, very difficult.

We feel badly for our borrowers. Should they not be able to refinance as contracted and agreed, notwithstanding their very good performance and improving credit metrics, we will be asking for them of something. We believe our job is to help rehabilitate businesses and get them back into the conventional business market – borrowing market.

If they are not capable of doing that, even if it's for a market related condition or issue, we believe that our shareholders are entitled to be compensated for that. So, that's a good example of notwithstanding no fault to the borrower, they are actually going to have to actually talk to us about an accommodation. That accommodation could be as simple as needing an extension.

We therefore see the yield enhancement as something that's been massively overlooked by the market, and in fact, probably accounts for virtually all of the difference in ROE between David's view and my view. My view is that ultimately, we are required to actually maximize the value for our own shareholders, while helping our borrowers. And we have to actually balance those two competing responsibilities.

But at the end of the day, our shareholders come first. And as a result, given how many and how quickly of these accommodations we're now seeing, seven in Q2, three more in process. That's 10 out of our portfolio of 40-odd loans. A quarter of our portfolio is getting yield enhancement above and beyond what's in our normal term sheets. You already saw the gross yield for the quarter is normalizing and our normal product right at around 20%, 19.9%, unlevered. And you see in Callidus Lite, it's normalizing right over 14%, which is exactly where we told people. It's a little bit higher than 14%. That means that the yield enhancement is going to take both of these over time significantly above the 20% and 14% targets.

In addition to that, you can see that leverage is going to go up. If we've made 19.9% in the conventional products and 14-and-change percent in Callidus Lite, resulting in an overall ROE of 13-point – I think it was six, 13.9%, that's right. Its year-over-year. It's up from 13.6%. Even though leverage had fallen, obviously, we've seen leverage returns going up, notwithstanding a negative to ROE, which is the IFRS change for this strange thing of accrued interest, which by the way, we also think that over time as we work out loans, we'll end up reversing some of it.

So, we actually see the ROE targets going up as a result of a bunch of issues. And you can see it in our performance, because we're already meeting the ROE targets notwithstanding a fall in leverage, and this IFRS issue related to capitalized interest going into the provision and then likely going out. And the reason I say likely going out is that we would not continue to lend to the borrower, unless we thought we were going to get that interest and our cost of capital back. So, we're now separating the interest issue.

So, people understand, this is going to create some volatility over time in our provision, because as the loans get worked out, we expect to get that interest recaptured. If we are correct in doing that, you're going to see reverses in provisions. And that's also going to increase ROE over time.

Scott Chan
Analyst, Canaccord Genuity Corp.

Q

So, I appreciate the guidance on the provision rate over the next few quarters. Just based on this new IFRS change, looking at medium term or long term, does this kind of increase your previous provision target of 102% over time?

Newton G. Z. Glassman
Executive Chairman & Chief Executive Officer, Callidus Capital Corp.

A

No. What will end up happening, we believe, is that we'll be back at the target within a quarter or two, but that really means we're below the target. Because it means that when we start recapturing the interest and/or the yield enhancement starts kicking in, not only will our net income go up, but the actual run rate of the provision will be going down.

Scott Chan
Analyst, Canaccord Genuity Corp.

Q

Okay. Thanks.

Newton G. Z. Glassman
Executive Chairman & Chief Executive Officer, Callidus Capital Corp.

A

We'll actually end up with a double whammy to the upside, to net income. Because ROE is going up, both because of yield enhancements and because of leverage, and that's even before we start going back and growing the book, which we suspect we will be doing fairly shortly once we decide what to do with cash and we see how the market's reacting to the stock price, and then on top of that you'll end up having increases in net income in a couple of lagged quarters, as interest issue starts working through the system.

Scott Chan
Analyst, Canaccord Genuity Corp.

Q

Okay. Thanks very much.

Newton G. Z. Glassman
Executive Chairman & Chief Executive Officer, Callidus Capital Corp.

A

And by the way, the banks have this exact same issue. They had, I think, about a year ago – roughly a year – a year-and-quarter.

Scott Chan
Analyst, Canaccord Genuity Corp.

Q

Okay. Thanks.

Operator: Showing no further questions at this time, we'll turn the call back over to the presenters.

David M. Reese
President and Chief Operating Officer, Callidus Capital Corp.

Thank you all for your questions. We look forward to seeing many of you over the coming weeks and reporting on our second quarter in a few months time. Enjoy your day, and thanks again for your support at Callidus, much appreciated.

Operator: Ladies and gentlemen, this concludes today's conference call. You may now disconnect.