Summary

Company's loan products may rely on numerous regulatory loopholes. Given the management's history, ELVT may become subject to significant regulatory scrutiny in the future.

ELVT's provision for loan losses typically averages around 50% of its revenues. All of its assets are pledged to secure its financing, with multiple loan quality covenants involved.

At a Price/Book of 3.2, the stock presents a significant risk mispricing.

Short Thesis Overview

Elevate Credit, Inc. (ELVT) is an online lender maintaining a public profile of a fintech. Via careful wording, well-thought-out interpretations, somewhat confusing comparisons and a possible use of regulatory loopholes, the company creates a number of first impressions that could be ripe for misinterpretation.

As a result, Elevate's stock price features a significant mispricing of operating, regulatory and economic risks. The article concludes with a "Short" rating, and I conclude on a 12-18 month price target of $2.57-3.86, implying downside of 55-70 percent.

The key possible misconceptions discussed in the short thesis include the following:

- *Elevate is a responsible lender and a proponent of brighter financial future for its customers.* ***Reality:*** According to lawsuit allegations, the two previous companies helmed by Elevate CEO - ThinkCash and then Think Finance - avoided state usury laws by operating schemes referred to as "rent-a-bank" and "rent-a-tribe."
- *As a data-driven lender employing AI and Machine Learning technology, the company has made sure that its charge-offs are nothing to worry about.****Reality:*** charge-offs typically average around 50% of Elevate's revenues.
- *Elevate's equity is a bet on its future growth.* ***Reality:*** Elevate's historical growth is built on rising debt. All of the company's assets are pledged to ensure its credit facilities with one alternative investment firm. With a Debt/Equity of 5.3 and multiple loan book quality covenants, equity holders may effectively be long the bottom tranche of Elevate's non-prime loan portfolio.
- *Elevate predecessor's charge-off rates were very stable over the Great Recession.* ***Reality:*** the actual data are too ambiguous to conclude upon its performance in 2007-2009. Elevate's former parent company Think Finance was formed in 2011. ThinkCash, its predecessor, had been forced to transform due to the FDIC coming after its rent-a-bank scheme with First Bank of Delaware. In 2017, Think Finance filed for bankruptcy a month before getting sued by CFPB. Reason? Usurious lending practices and a rent-a-tribe scheme.
- *Elevate's loan brands pose no regulatory or operational risks.* ***Reality:***since its loan products may rely on certain regulatory loopholes, their success partially depends on the level of federal regulators' ignorance.
- *Elastic loan brand, run in a partnership with Republic Bank & Trust Company, is a sign that the banks are willing to partner with Elevate on new products.* ***Reality:*** the partnership may essentially be a rent-a-bank scheme used to avoid state usury caps, similar to the one operated by Elevate CEO Ken Rees via ThinkCash before the FDIC took action. Republic only retains 10% of the loan balances and may pose an operational risk should it choose to fold the operation (as it did with its payday loan operation in 2006 after being asked by the FDIC).
- *Advanced technology allows the company to avoid non-performing debt collection. The company is a responsible lender and adheres to the principle of lending on honor.* ***Reality:*** the company actively uses outsourced debt collection services.
- *There are no reasons to expect that Victory Park Capital could at certain conditions withdraw its financing.* ***Reality:*** according to the official version, the bankruptcy of Elevate's former parent company was caused by the investment firm.
- *Funded by multiple Venture Capital firms, the company benefits from their continuous support and management expertise.* ***Reality:*** as a part of the investment process, VC firms typically look for a viable strategy to exit their illiquid investments (e.g. an IPO). After being named as defendants in a lawsuit involving Elevate's former parent, VCs may soon begin getting second thoughts about holding on to the stock.

The company did not reply to an email request to comment upon the statements that (1) Elevate's Rise and Elastic loan brands may be based on certain regulatory loopholes, (2) Elevate's relationship with Republic Bank may represent a rent-a-bank scheme aimed to avoid state usury laws in the US and that (3) APRs offered by Elevate's loan brands could be classified as predatory.

This report is structured as follows:

1. Business and competitive landscape.
2. Competitive edge, both on the product and technological front.
3. Loan book quality and seasonality.
4. Margin and cost analysis.
5. Think Finance and Elevate spin-off.
6. Think Finance lawsuits and parallels with Elevate.
7. Operating structure, debt and covenants.
8. Operating structure of Elastic.
9. Elevate's public image, perception and reality.
10. Regulatory environment.
11. Risks overview.
12. Conclusion.
13. Exhibits.

The short thesis is grouped into 19 numbered arguments highlighted in bold.

Analysis

Elevate Credit, Inc. is an online credit solutions provider operating in the US and UK. It is a 2014 spin-off of Think Finance, Inc. ("TFI"). The company specializes in non-prime consumer loans for individuals cut off from the traditional banking industry and essentially positions itself as a more affordable alternative to pawn, payday, title and storefront installment loans.

As of this writing, the company has issued loans totaling $5.9bn for more than 2 million customers.

To date, company's product offering is composed of the following:

- RISE: easy-to-apply loans and lines of credit for a total of $500-7,000, available in 17 US states;
- ELASTIC: unsecured line of credit for a total of $500-3,500, available in 40 US states;
- SUNNY: easy-to-apply loans for a total of £100 - £2,500, available in UK;
- TODAY: a credit card offering a credit line of up to $3,500, availability details are not out yet.

The key selling points of Elevate's credit product offerings are as follows:

- *Speed:* with loan applications happening online, customers can expect to receive a cash loan within 15 minutes. *"Money as Soon as Tomorrow*" - ELASTIC.
- *No hidden fees:* avoiding traditional application, administration and late payment fees, Elevate's marketing puts significant emphasis on transparency. *"We never charge fees.*" - SUNNY.
- *Competitive pricing:* priced about 50% lower than comparative payday loans (10-K, p. 11), the company makes it its mission to let its target customer save. *"Elevate customers have saved more than 4 billion over payday loans.*" - Q2 2018 earnings release.
- *5-day risk-free guarantee:* no fees charged to a customer returning the principal within 5 business days, no questions asked. "*If you decide that the loan isn't right for you, simply call us, repay the principal and there will be no fees.*" - RISE.
- *Rates that go down with time (for RISE):* possibility of a 50% interest rate reduction for recurring customers with a payment history of 24+ months and a starting rate below 75%, as well as a chance to receive a 36% rate after another 12 payment months.

Elevate's entire business model is built on the premise that the non-prime consumer's credit needs remain vastly underserviced. Representing around 44% of total US population, non-prime consumers - together with credit invisibles (22%) - have been mostly disregarded by the majority of US and UK banks since the Great Recession. Citing a $142bn reduction in non-prime credit since 2008, the company clearly sets the point that the market is sizeable. It should also include a number of prospective prime consumers with limited or no credit history (e.g. students, immigrants).

However, the company takes it to a new level by positioning itself as a responsible lender for the target customer base it calls "the New Middle Class" - individuals with pressing credit needs, zero to no savings and few credit options.

Per company's website, the current budgetary actualities of the New Middle Class are as follows:

- 4 out of every 10 Americans face monthly income variations of more than 30%;
- 4.6 out of every 10 Americans couldn't pay for a $400 emergency with cash on hand.

Let's now turn our attention to the company's competitive landscape.

1. Elevate is likely to face a significant pick-up in competition from banks, marketplace and different online data-driven lenders. With a lower cost of capital, banks may be able to afford acquisitions, technology investments and more competitive APRs.

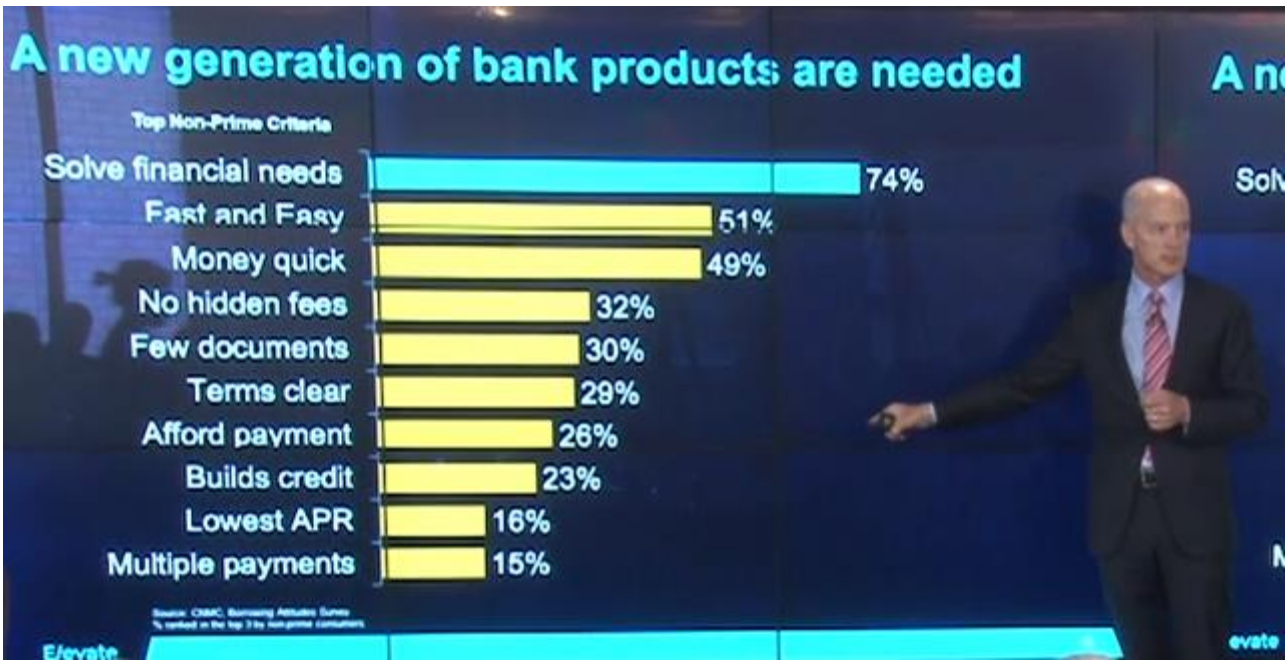
"Legacy non-prime lenders are not innovative." - industry overview section, Elevate's latest 10-K.

Disruptive fintech or the same old payday lending story? When asked how does the company actually help its customers to *"get out of that endless debt cycle*" during a Sarder TV interview, Ken Rees, Elevate CEO, pointed out the importance of reporting to credit bureaus as numerous payday lender customers with absent or damaged credit history are looking to improve their credit rating. That - in combination with an advertised 50% cut on payday lenders' rates - most certainly acts as a clear differentiator in customers' eyes. However, how likely is it that the company's competitive edge will face no pressure from intensifying competition? The true percentage of payday lenders reporting to bureaus is certainly up for a debate given the wide presence of web articles discussing the use of payday loans to improve one's credit score (despite some of the articles arguing that payday loans are also likely to be seen as a desperate measure and only impair one's score). While the company is certainly right to advertise its reporting advantage, one may assume that continued growth in payday lending is likely to increase the number of reporting players in the coming years.

Where would additional competition come from? At a Bloomberg Next Tech Event in March 2018, Ken Rees clearly admitted that *"there is every reason to believe that banks are going to be able to offer incredibly low-priced credit to non-prime customers, much lower than a non-bank lender would."* Yet for some reason, he also believes that they *"just are not going to be able to innovate."* He further added, *"Although some of the biggest banks may be able to afford some investments into technology and advanced analytics, we've got thousands of community banks in the US, and there is absolutely no way that they are going to be able to do that as well."* While he finishes his speech by suggesting that the most value added to the non-prime market would come from fintech partnerships with banks, wouldn't this also imply that ***competition is likely to escalate*** given how easy it would be for major US players to acquire or partner with fintechs? There is a growing evidence that banks are able to enter and compete in the space. As to the community bank argument, one should also point out that their inability to innovate (and thus provide credit to non-prime) only represents a large untapped market for major players to enter in the coming years.

With no explanation provided, I find Rees' innovation argument to be relatively biased. With access to cheap capital, banks can easily afford innovation (e.g. Marcus by Goldman Sachs) and are already backing numerous fintechs (US, EU examples). With many of them having their own startup labs/accelerator programs, the space also continues to receive significant attention from venture capital and technology companies, oftentimes resulting in fintechs backed by players from different industries (e.g. Dave.com backed by JPMorgan and others).

It's fair to assume that higher competition would drive down prices (APRs). Jumping back to an earlier part of the presentation, one should consider the fact that a mere 16% of CNMC survey respondents placed APRs among the 3 most important criteria in their choice of non-prime credit options. Following this logic, Elevate's ***recent efforts to compete via lower rates could not only be costly, but also unnecessary.***



*"Barely 16 percent of non-prime consumers think that the lowest APR is even in their top 3 most important criteria for selecting a loan. Instead, what they're looking for are "fast", "easy", "*get *my money in my bank account so I can useit." - Ken Rees, Elevate CEO during a presentation at Bloomberg Next Tech Event. Source: YouTube.*

2. Elevate's competition is likely to have an advantage on customer acquisition costs. With banks having a direct access to the non-prime customer, Elevate's marketing program is mainly based on pre-screened mail offers. Consumers can opt out from receiving those.

How innovative is physical mail? Despite dubbing legacy non-prime lenders non-innovative for not being online, Elevate performs the majority of its integrated multi-channel marketing through direct mail advertising (54% in 2017, see p. 8). Targeted mail is commonly sent out to pre-screened individuals with a somewhat incentivizing message like *"You are already pre-qualified for 2250 dollars which can be deposited into your account as soon as tomorrow,"* as seen in this YouTube video. Is there anything that could prevent Elevate from reaching out to its prospective customers that way? Here's Federal Trade Commission to explain: *"If you decide that you don't want to receive prescreened offers of credit and insurance, you have two choices: You can opt out of receiving them for five years or opt out of receiving them permanently."* For more detail, see here. According to the 10-K, around 99% and 44% of Elastic and Rise customers obtained a loan on the basis of a pre-approved offer in 2017.

Elevate's other marketing channels include digital (23%), strategic partners (15%) and TV & mass media (8%), according to 2017 data.

Despite the company seeing notable progress on the customer acquisition cost since 2014 ($297), its CAC fell to $256 in 2015 and appears to have bottomed in 2016 ($235), rising to $237 in 2017. While still relatively expensive, one may also argue that banks - with direct access to prospective customers - are likely to have minimal costs should they start lending to non-prime. According to Elevate's own data, 65% of non-prime Americans have a customer relationship with a traditional bank.

Summarizing what's been just discussed, ***it might be far-fetched to expect Elevate's competitive edge to stay immune to the anticipated competition.*** Cheaper debt availability (vs. Elevate's cost of debt at around 15% as of this writing), direct access to non-prime customers, experience with credit bureau reporting and startup partnerships/acquisitions would make banks a competitor that's likely too tough to ignore.

Source: made by the author.

3. Given mixed economic data and similarities with competing data-driven lenders, the notion that ELVT's valuation deserves a technology premium may be disputed. It could make more sense to focus on the charge-off rates.

Having discussed the competitive landscape of Elevate's product offerings, let's now turn to the second part of the equation - risk analytics. Development of non-prime lending faced the need to expand the analysis beyond the mostly backward-looking data of credit scores and dive more into non-credit history. Dealing with payday loans means dealing with the much less predictable: according to Skiba and Tobacman (2008), an average default occurs after the individual has already serviced or repaid five payday loans. Per The Economist, Rees mentioned having frequent conversations with fintechs promoting their data analysis edge, whereas in reality *"they mostly just extend the realms of the banked to bring in those who, even on a cursory check, would have been included anyway."*

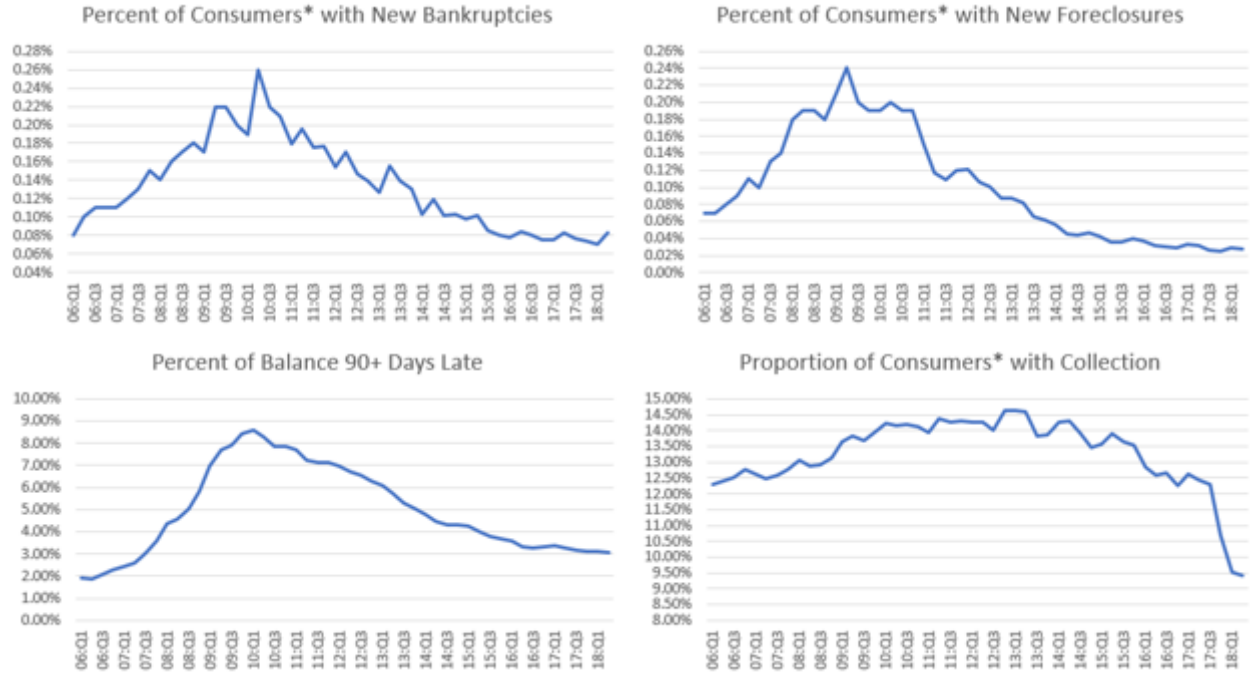
Elevate is not too shy when speaking about its own data analysis edge, and perhaps rightfully so. In the latest 10-K, the company describes its tools as *"industry-leading technology and proprietary risk analytics optimized for the non-prime credit market."* Employing a wide spectrum of traditional and trendy methods - including multivariate regressions, machine learning and artificial intelligence - the company has reached the point of 95% automation and has no intention to stop. Made in a matter of seconds, application decision involves tens of thousands of variables analyzed via DORA, the company's proprietary risk analytics platform.

To give some perspective, here is a quote from Provenir's interview with John Bartley, Elevate's UK Team Lead in Data Science:

"Our risk analytics stack utilizes a terabyte-scale Hadoop infrastructure composed of thousands of elements, customer records, and other wide-ranging data inputs including credit bureau data, web behavioral and performance data, bank transaction data and other non-traditional data. All of this works to give us a holistic view of the customer and helps us accurately assign risk to those applications. Advanced machine learning techniques let us consider these factors in the development of algorithms which better predict behaviour and customer vulnerability […] Using appropriate modeling techniques has allowed us to significantly simplify our underwriting and lead to more accurate predictions of likely loan performance."

Technological edge or just a by-product of a favorable economic environment? The answer to that question depends on the data you look at. The recent downtrend in charge-off rates has been accompanied by mixed U.S. economic data. Readings on credit card charge-off rates, especially for the banks outside of the Top 100 by assets, have already reached recessionary levels (see here). The same charge-off rates for all commercial banks, however, remain relatively low in comparison with the levels seen in 2008-10, despite the recent growth (3.8% in Q1 2018 vs. 2.8% in Q3 2015). Finally, data on consumer bankruptcies, delinquencies, foreclosures and collection - which

could probably be even more relevant for Elevate - have witnessed a noteworthy improvement lately. Even the Elevate CEO has recently tweeted about the falling household default figures.



**Based on the population with a credit report. Made by the author. Source: New York Fed Consumer Credit Panel/Equifax, from the NY Fed's Quarterly Report on Household Debt and Credit.*

While the true extent of Elevate's analytical edge will be tested by time, the number of fintechs offering outsourced loan analytics (including its former parent Think Finance) hasn't been too scarce lately. With the emergence and growth in marketplace lending, banking startups and other players, big data is increasingly becoming an industry standard for online lending. It thus raises the question whether Elevate's technology is indeed cutting edge and warrants a valuation premium.

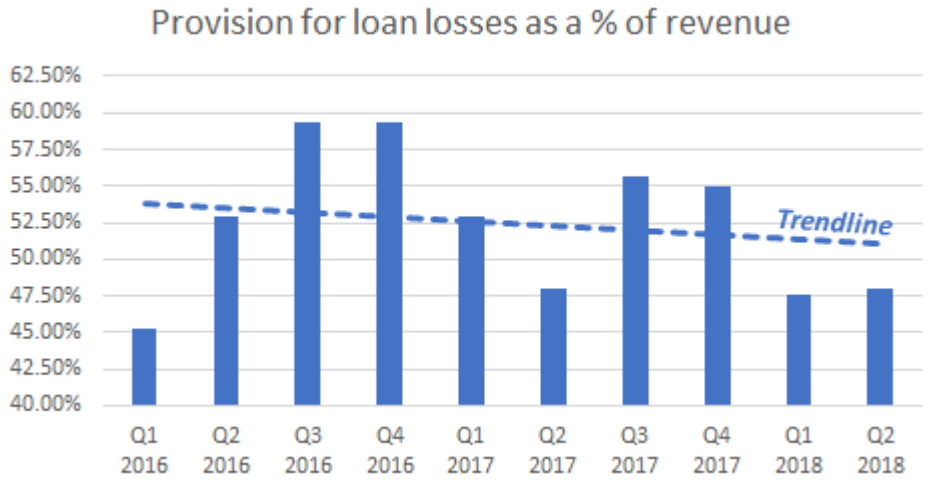
Let's search for an answer in the charge-off rates.

4. ELVT's loan book quality may serve as a bearish catalyst for its future valuation. Over the last three years, its loan loss provisions averaged 52.7% of the quarterly revenue.

With a rising number of online lenders having access to sophisticated algorithms automating the application process, one may probably view charge-off rates as a key distinguishing factor that has the most room for improvement.

Data for payday loan charge-off rates isn't that easy to find. It is known that the rates are, well, elevated, and can vary significantly by state. According to research by Montezemolo and Wolff (2015), 54% of Texas borrowers defaulted within twelve months of taking their 1st payday loan in Skiba & Tobacman (2008), whereas the number was only 37% for Oklahoma in King & Parrish (2011). The paper also notes that Texas data demonstrate a 53% default rate on payday installment loans in 2013 (which should probably imply rates of 62%, 59% and 49% in 2014, 2015 and 2016, respectively, if my understanding of the methodology is correct).

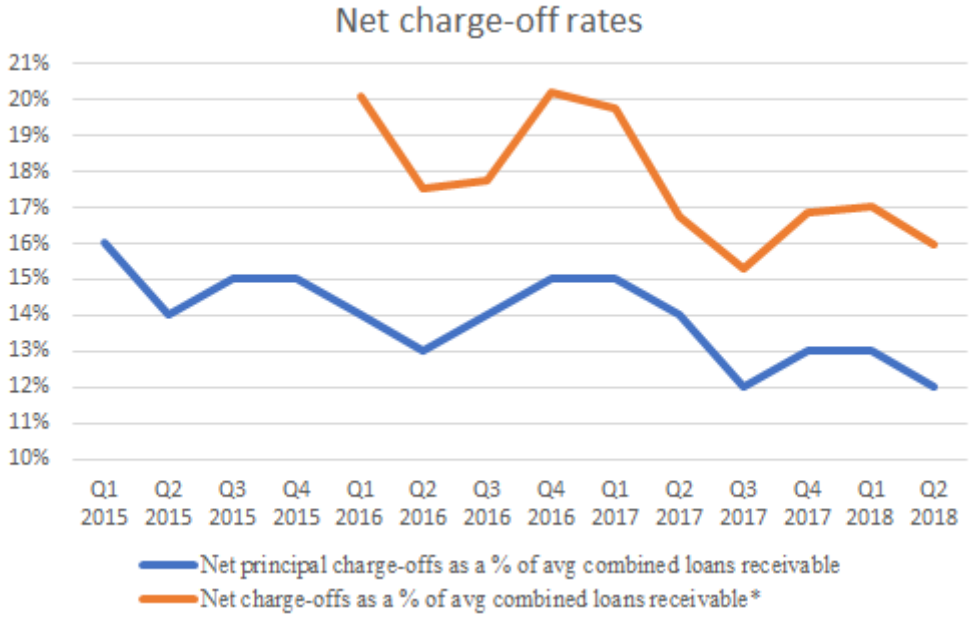
Alright, so how are the today's numbers looking? It is not without a reason that Elevate commonly reports its loan loss provisions expressed as a percentage of its revenue. Averaging a staggering 52.7% over the last 12 quarters, the ratio tends to increase into the second half of the year.



Made by the author. Source: company's filings.

Overall, the performance of Elevate's charge-off rates has been pretty stellar lately - there is no denying about that. Net charge-off rates have been trending lower throughout the last couple of years, bottoming at 15.3% in Q3 2017 and seeing a modest seasonal increase over the consequent quarters.

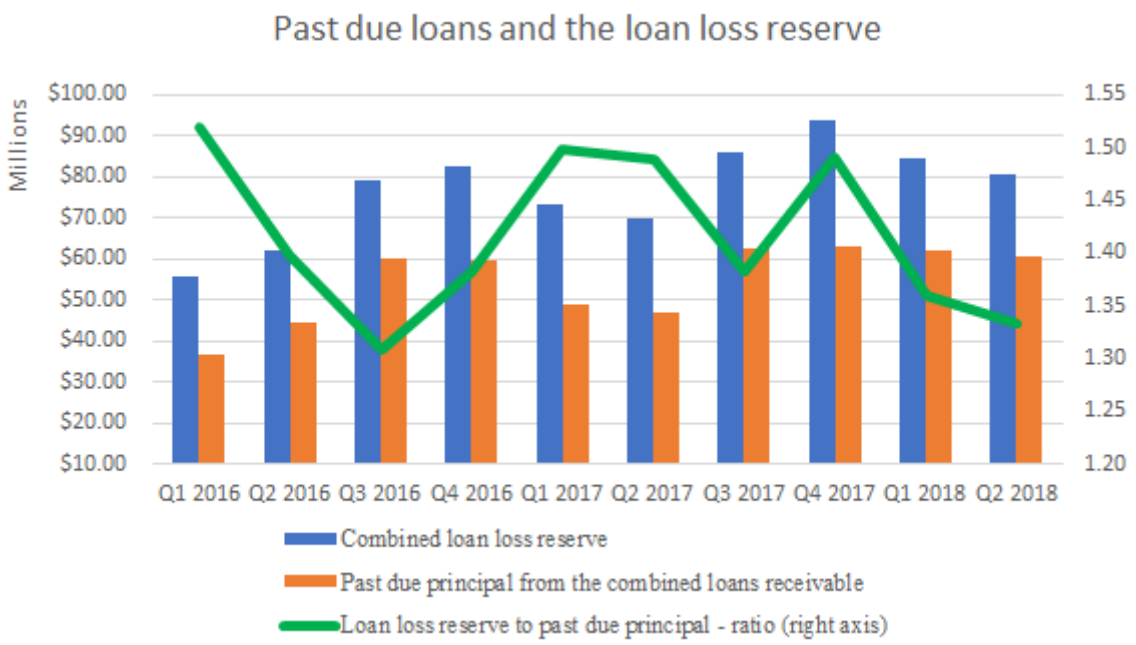
Instead of reporting simple charge-off rates common for the banking industry, ***the company prefers reporting its net principal charge-off rates which, in contrast to net charge-off rates, exclude accrued interest (see below).*** To give more perspective, the chart below includes both. Given that combined loan portfolio's effective APR totaled 129% in the 1H 2018 (10-Q, p. 41), it probably makes sense to focus on the more standard measure.



**Data for average combined loans receivable (principal) is only available starting from Q1 2016. Made by the author. From the 10-K: "Net charge-offs include the amount of principal and accrued interest on loans that are more than 60 days past due, or sooner if we receive notice that the loan will not be collected, such as a bankruptcy notice or identified fraud, offset by any recoveries." Source: company's filings.*

5. Given the large provisions, Elevate's loan loss reserve seasonality has been a key bottom line driver lately. As the seasonality effect generally favors the first two quarters of the year, the company tends to significantly overestimate its annual guidance. As seen in the annotated stock price chart, earnings-focused investors tend to react to subsequent negative changes in guidance.

Past due loans as a percentage of total loans receivable have been on a decline lately, fueling a parallel decrease in the combined loan loss reserve ("LLR") - a topic that needs to be addressed in more detail. Based on a number of factors such as delinquency status, historical loss rates, number of payments and percentage of principal past due, Elevate's LLR methodology differs for each loan product and geography.

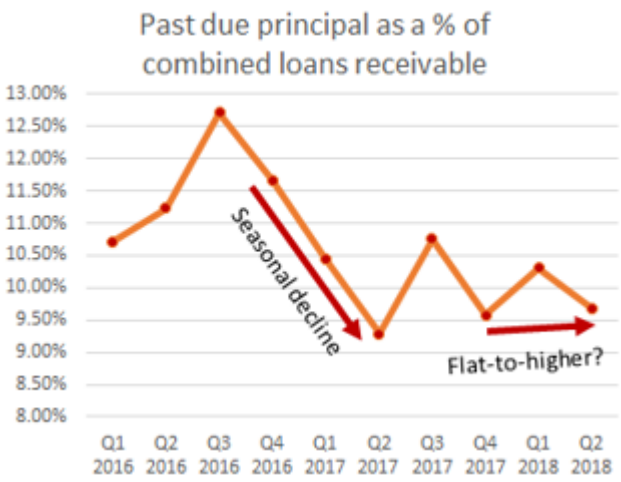


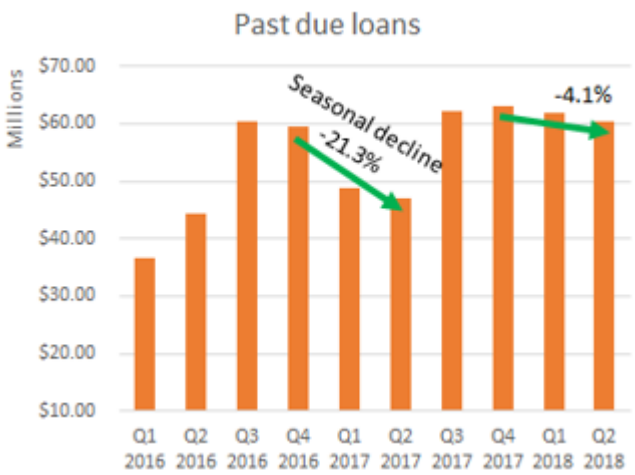
Made by the author. Source: company's filings.

LLR dynamics closely coincide with the company's loan book seasonality. With the arrival of tax refunds in the first half of the year, a significant share of Elevate's customers pays off - either partially or in full - the debt that's been accumulated over the 3rd and 4th quarters (holiday season).

Following the recent tax reform, however, the timing of 2018 tax refunds wasn't as clear as it's been in the previous years, resulting in a smaller-than-usual decline in Elevate's past due principal. While the significance of this development may be downplayed and deemed a one-off event, it is possible that the situation will become even more complex in 2019. According to a simulation by the Government Accountability Office, the share of taxpayers with overwithheld taxes - the ones getting a refund - would be approximately 76% prior to the change in tax legislation. Following the reform, however, this figure is forecast to decline to 73%, resulting in about 30 million households actually owing more money.

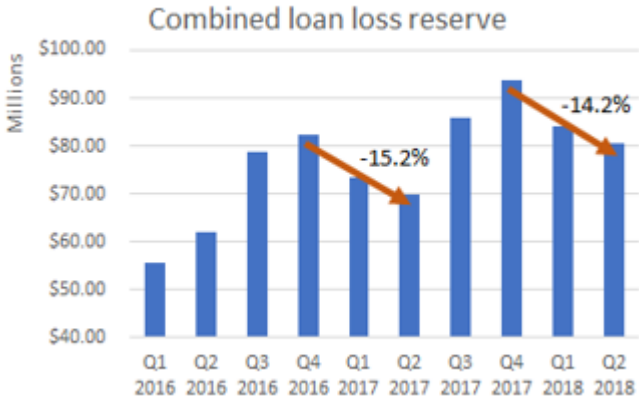
The figure below illustrates the recent LLR controversy. ***The cyclical Q4-Q2 decrease happened in spite of an acyclical build-up in past due principal and its historical relationship with LLR:*** *"An increase in past due loans will cause an increase in our combined loan loss reserve and related additional provision for loan losses to increase the reserve."*





Methodology (simplified):

Loss factors determined by delinquency status (current, 1-30 and 31-60 days past due)
+
Percentage of past due combined loans receivable
+
Loss rates by the number of payments
=
Loan Loss Reserve



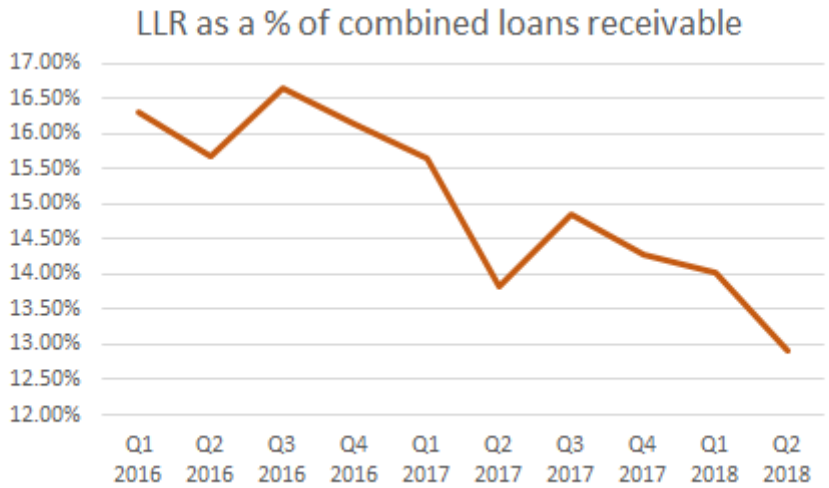
Made by the author. Source: company's filings.

The above-discussed decline may not be too dramatic by itself, but it brings LLR to a new low in relation to combined loans receivable. The ratio has been in a decline throughout the entire SEC filing history of Elevate:

"Based on this methodology, we have historically seen our combined loan loss reserve as a percentage of combined loans receivable fluctuate between approximately..."

Q1 2017:	**16%** and 24%
Q2 2017 and later:	**14%** and 24%
Q2 2018:	**13%** and 24%

"...Depending on the overall mix of new, former and past due customer loans."



Made by the author. Source: company's filings.

While this could probably be influenced by variations in product and geographical distribution, one should still note that fluctuations in LLR have been a deciding factor for Elevate's bottom line, and the company hasn't been too profitable lately. The market may be paying its quarterly results way more attention than it should be. Instead, what it should probably focus on is the seasonality in additional provision for loan losses ("APLL").

The mechanics here are pretty simple. In Elevate's LLR methodology, its total provision for loan losses is divided into two parts. The standard provision equals the total of net charge-offs during the period. It is summed up with the additional provision for loan losses - the seasonality factor used to control for changes in loan book size and quality. As the loan book expands in the second half of the year, APLL is typically positive to drive the LLR higher. In anticipation of a decrease in the loan book in the first half, APLL is typically negative to readjust the LLR lower.

Here's how it looks in perspective. The table below presents a condensed version of Elevate's income statement, with other related metrics and expanded loan loss provisions at the bottom.

As discussed previously, seasonality has a significant impact on the loan loss reserve and thus provision for loan losses, which eventually decide whether the company is profitable in a given quarter. Negative APLLs in the first half of the year are highlighted in yellow; adding those negative numbers back would result in all of the 1H quarters reporting a loss. As the seasonality is reversed come the second half of the year, 2H quarters are typically much less profitable. In the meantime, changes in credit quality may also result in APLLs being positive in 1H, as it was in Q2 2016 (highlighted in grey). Since the provisions decrease in 1H 2018 might not appear that justified given what's been discussed as the recent LLR controversy, there may be a reason to expect a more pronounced reversal in quarters 3 and 4.

In $1000s	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018
Revenues	$130,722.00	$126,780.00	$153,920.00	$169,019.00	$156,367.00	$150,471.00	$172,851.00	$193,443.00	$193,537.00	$184,377.00
Provision for loan losses	$ 59,089.00	$ 67,134.00	$ 91,282.00	$ 100,316.00	$ 82,793.00	$ 72,297.00	$ 96,203.00	$ 106,281.00	$ 92,142.00	$ 88,598.00
Direct marketing costs	$ 9,606.00	$ 17,683.00	$ 22,912.00	$ 14,989.00	$ 10,488.00	$ 19,592.00	$ 20,242.00	$ 21,900.00	$ 20,695.00	$ 22,180.00
Other cost of sales	$ 3,583.00	$ 4,323.00	$ 4,958.00	$ 4,569.00	$ 4,108.00	$ 4,425.00	$ 5,834.00	$ 6,169.00	$ 6,329.00	$ 6,566.00
Total cost of sales	$ 72,278.00	$ 89,140.00	$ 119,152.00	$ 119,874.00	$ 97,389.00	$ 96,314.00	$ 122,279.00	$ 134,350.00	$ 119,166.00	$ 117,344.00
Gross profit	**$ 58,444.00**	**$ 37,640.00**	**$ 34,768.00**	**$ 49,145.00**	**$ 58,978.00**	**$ 54,157.00**	**$ 50,572.00**	**$ 59,093.00**	**$ 74,371.00**	**$ 67,033.00**
Total operating expenses	$ 31,928.00	$ 33,421.00	$ 34,969.00	$ 31,875.00	$ 37,362.00	$ 38,824.00	$ 37,130.00	$ 38,621.00	$ 41,742.00	$ 43,317.00
Operating income	**$ 26,516.00**	**$ 4,219.00**	**$ (201.00)**	**$ 17,270.00**	**$ 21,616.00**	**$ 15,333.00**	**$ 13,442.00**	**$ 20,472.00**	**$ 32,629.00**	**$ 23,716.00**
Total other expense	$ (14,858.00)	$ (17,581.00)	$ (18,633.00)	$ (22,057.00)	$ (18,811.00)	$ (13,733.00)	$ (16,831.00)	$ (18,473.00)	$ (18,495.00)	$ (20,494.00)
Income (loss) before taxes	**$ 11,658.00**	**$ (13,362.00)**	**$ (18,834.00)**	**$ (4,787.00)**	**$ 2,805.00**	**$ 1,600.00**	**$ (3,389.00)**	**$ 1,999.00**	**$ 14,134.00**	**$ 3,222.00**
Income tax expense (benefit)	$ 5,866.00	$ (5,866.00)	$ (2,587.00)	$ (365.00)	$ 1,137.00	$ (1,420.00)	$ (3,979.00)	$ 14,193.00	$ 4,651.00	$ 94.00
Net income	**$ 5,792.00**	**$ (7,496.00)**	**$ (16,247.00)**	**$ (4,422.00)**	**$ 1,668.00**	**$ 3,020.00**	**$ 590.00**	**$ (12,194.00)**	**$ 9,483.00**	**$ 3,128.00**
								($0.3mn without the one-off tax charge)		
Diluted earnings per share	$ 0.20	$ (0.59)	$ (1.25)	$ (0.34)	$ 0.06	$ 0.08	$ 0.01	$ (0.29)	$ 0.22	$ 0.07
Diluted weighted average shares outst.	28,806,417	12,800,795	12,976,067	13,002,728	28,735,749	39,950,760	43,158,515	42,247,900.00	43,680,603	44,239,007
Net charge-offs/revenue	52.79%	47.45%	48.16%	57.04%	58.79%	50.66%	46.42%	50.98%	52.72%	49.77%
Provision for loan losses/revenue	45.20%	52.95%	59.30%	59.35%	52.95%	48.05%	55.66%	54.94%	47.61%	48.05%
	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018
Net charge-offs	$ 69,010.00	$ 60,153.00	$ 74,125.00	$ 96,412.00	$ 91,928.00	$ 76,232.00	$ 80,232.00	$ 98,618.00	$102,042.00	$ 91,756.00
Additional provision for loan losses	$ (9,921.00)	$ 6,981.00	$ 17,157.00	$ 3,904.00	$ (9,135.00)	$ (3,935.00)	$ 15,971.00	$ 7,663.00	$ (9,900.00)	$ (3,158.00)
Provision for loan losses	$ 59,089.00	$ 67,134.00	$ 91,282.00	$100,316.00	$ 82,793.00	$ 72,297.00	$ 96,203.00	$106,281.00	$ 92,142.00	$ 88,598.00

Made by the author. Source: company's filings. Note that, despite an approximately 26% increase in the loan book, total negative APLLs in 1H 2018 and 1H 2017 are almost equal ($13.06 and $13.07 million). Positive APLLs, however, saw an annual increase to $23.63 in 2H 2017, vs. $21.06 million in 2H 2016.

To further illustrate the seasonality, as a percentage of revenue, quarterly provisions for loan losses historically averaged 49.1% in the first half of the year, vs. 57.3% in the second half. In comparison with 2016 and 2017, the ratio for 1H 2018 averaged 47.8% vs. 49.1% in 2016 and 50.5% in 2017.

Q1 16	Q2 16	Q3 16	Q4 16	Q1 17	Q2 17	Q3 17	Q4 17	Q1 18	Q2 18
45.20%	52.95%	59.3%	59.35%	52.95%	48.05%	55.66%	54.94%	47.61%	48.05%

Total provision for loan losses as a percentage of quarterly revenues. Source: made by the author using the data from company's filings.

The key problem with the seasonality is, ***while on an upbeat note, Elevate tends to significantly overestimate its annual guidance in the first half of the year.*** How does the stock react? As can be seen in the annotated chart below, the market didn't enjoy the 2017 net income and adjusted EBITDA miss in early February. Even though one may note that ELVT's trading history doesn't span far enough to make conclusions, the stock has been generally bid up into earnings, probably due to an optimistic guidance at the year's start. The October rally between the earnings date announcement and the actual report was remarkable. Sometimes, like in

July and October 2017, as well as in July 2018, earnings optimism for ELVT cools down just before the announcement.

Following the 15.3% plunge after the 2017 results miss, sentiment hasn't been that bullish in anticipation of Q1 2018. Enter our friend APLL. With the help of LLR seasonality, the company managed to squeeze out a record quarterly profit, probably its largest this year. Why? As I've discussed previously, ***due to a smaller decrease in past due loans, the 1H 2018 APLL may appear much less justified than the previous year's.*** Since the company has the capacity to influence its APLL with a notable impact on the bottom line (and little transparency), ***one may hypothesize that it could serve as a temporary sentiment fixer for earnings-focused investors, forcing a stronger reversal in provisions once the seasonality kicks back in.*** Although the upbeat 2018 guidance was slightly lowered on the upper side in Q2 2018, it appears that the market continues to buy the upbeat 2018 outlook for now.

ELVT price chart from the IPO through August 23, 2018. Made by the author. Source: Yahoo Finance and company's press releases.

6. Customer acquisition costs ("CACs") and APRs are likely to weigh on the company's margins going forward. Decrease in CACs appears to have stabilized. Given the growth in Elastic, the metric is likely to see a pick-up in the coming years. Although the downtrend in APRs is slowing down, the company is unlikely to raise its rates significantly.

Despite the company painting itself as a tech growth story (which it undeniably is if loan growth is in the focus), its historical operating performance doesn't agree. Historical free cash flow generation has been relatively weak, totaling $19.9mn, $16.7mn and an outflow of $1mn in 2016, 2017 and the first six months of 2018, respectively. As the loan book expansion remains dependent on external financing, top line growth may be challenged to keep up with the rising costs.

While the presentations continue to tout the consistent, within-estimate customer acquisition costs ("CACs," see p. 8), strong growth in the Elastic brand should be paid attention to. With CACs declining for Sunny and almost flat for Rise, the small total increase in 2017 was mostly attributed to Elastic.

Customer Acquisition Cost Distribution

Rise	2015	2016	2017	2018
Q1	N/A	$ 275.00	$ 306.00	$ 333.00
Q2	N/A	$ 293.00	$ 400.00	$ 307.00
Q3	N/A	$ 278.00	$ 240.00	
Full year	$ 275.00	$ 278.00	$ 281.00	

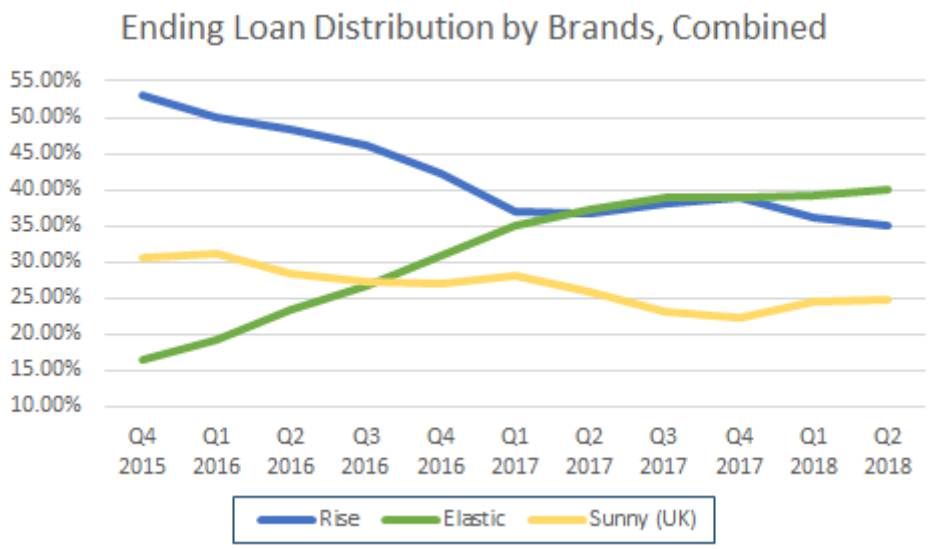
Elastic	2015	2016	2017	2018
Q1	N/A	$ 167.00	$ 150.00	$ 275.00
Q2	N/A	$ 144.00	$ 176.00	$ 234.00
Q3	N/A	$ 141.00	$ 168.00	
Full year	$ 132.00	$ 152.00	$ 182.00	

Sunny (UK)	2015	2016	2017	2018
Q1	N/A	$ 226.00	$ 181.00	$ 279.00
Q2	N/A	$ 330.00	$ 315.00	$ 243.00
Q3	N/A	$ 265.00	$ 287.00	
Full year	$ 295.00	$ 259.00	$ 249.00	

Total	2015	2016	2017	2018
Q1	N/A	$ 235.00	$ 198.00	$ 295.00
Q2	N/A	$ 258.00	$ 294.00	$ 260.00
Q3	N/A	$ 234.00	$ 222.00	
Full year	$ 256.00	$ 235.00	$ 237.00	

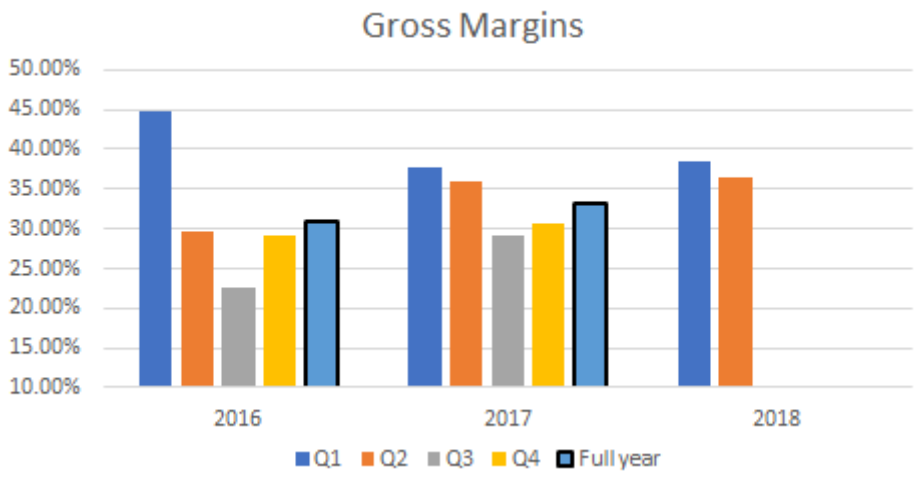
Made by the author. Source: company's filings.

Unless the growth in Elastic slows down, it would most probably result in stable, if not higher, CACs in the future quarters. A headwind to name could be the ongoing decline in Elastic's average loan balance, which fell to $1,784 in 2017, vs. $1,909 and $2,030 in 2016 and 2015, respectively. For Rise, with its less pronounced pick-up in CACs, the average loan balance continued to advance and reached $2,276 in 2017, vs. $2,196 and $2,057 in 2016 and 2015, with a mostly flat dynamic for Sunny.



Made by the author. Source: company's filings.

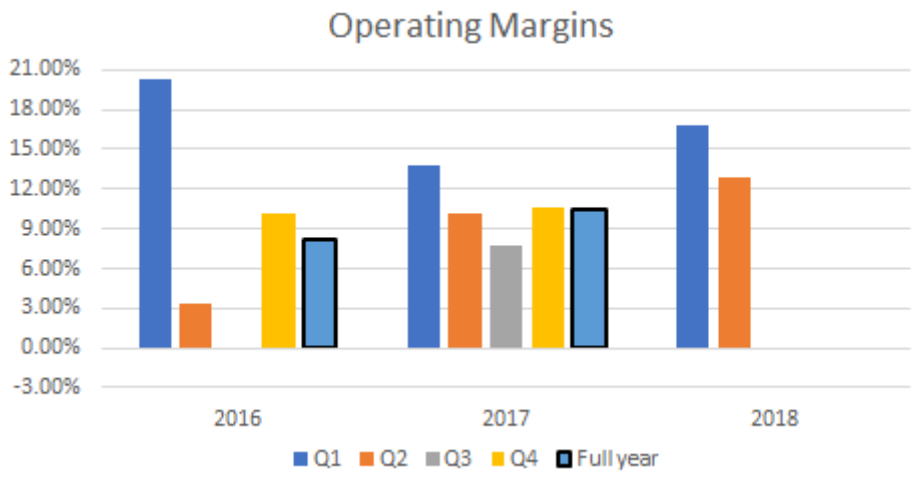
Over the last couple of years, company's gross margins averaged 37.2% in the first half of the year, followed by a seasonal decline to an average of 27.9% in the second half.



Made by the author. Source: company's filings.

What about other costs? Due to the ongoing expansion in office space and employee count, Elevate's operating costs have been seeing a significant pick-up in occupancy, equipment and compensation related expenses, which is likely to continue.

Helped in part by loan loss provisions, which in 2018 averaged 47.8% vs. 50.6% in the first half of 2017, operating margins saw a significant improvement in the first half of 2018.

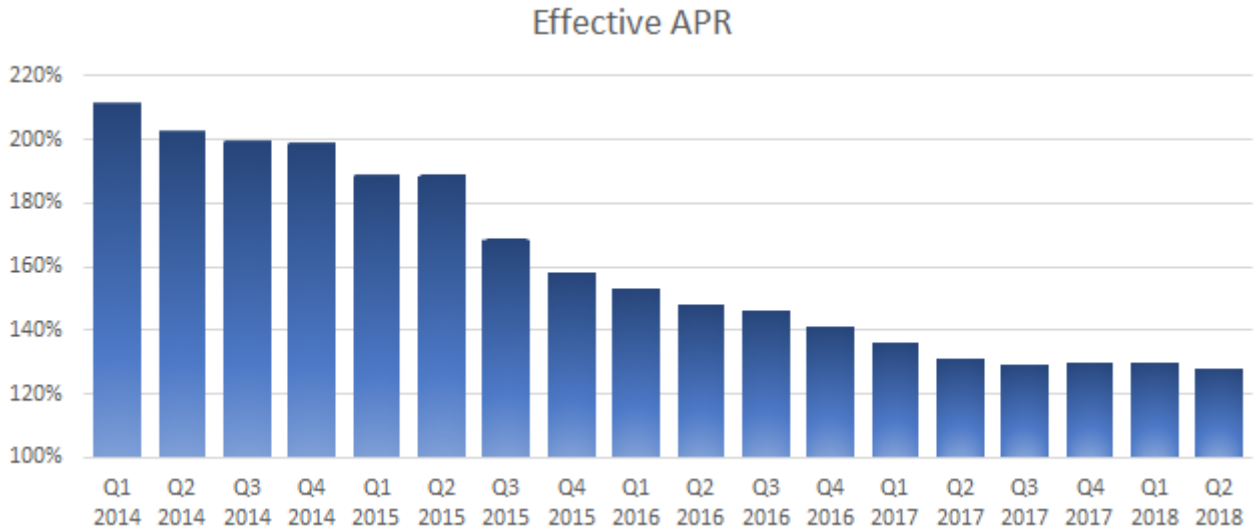


Made by the author. Source: company's filings. Operating margin for Q3 2016 was -0.13%.

On a long-term basis, Elevate expects operating margins to stabilize near the 20 percent level (10-K, p. 71):

"We aim to manage our business to achieve a long-term operating margin of 20%, and do not expect our operating margin to increase beyond that level, as we intend to pass on any improvements over our targeted margins to our customers in the form of lower APRs."

Falling APRs continue to weigh on the revenue. The source of near-term margin improvement, in the meantime, isn't that clear given the recent CAC and APR performance. Although the APRs appear to be stuck around the 130 percent level for now, the pressure would continue should the downward move resume. A reversal to the upside, in the meantime, would imply a violation of Elevate's social mission: *"We believe this is a critical component of our responsible lending platform and over time will also help us continue to attract new customers and retain existing customers."*



Made by the author. Source: company's filings.

By this point, we've discussed Elevate's business and competitive environment, credit quality, key bottom line drivers and earnings quality. However, we are nowhere near as close to making conclusions before we discuss its operating structure. And to do so without overlooking the crucial details, we will have to make a step way back and look at the bigger picture.

An integral part to understanding today's Elevate is knowing its past. The following sections discuss Think Finance - Elevate's former parent company.

7. Elevate's filings provide limited information on its former parent. The actual reasons behind the Elevate spin-off are open to debate. Victory Park Capital, which caused TFI's bankruptcy, remains a key source of financing for Elevate. Without a proper understanding of TFI's bankruptcy and its relationship with VPC, investors may be underestimating a number of risks involved.

While Think Finance is only briefly described in the 10-K, (see p. 33), its past may certainly provide some color on Elevate's management and have potential implications for the company (as described on p. 51).

Founded in 2001, TFI raised $60 million from Sequoia Capital, Technology Crossover Ventures and others. Prior to the spin-off of its lending operations in the form of Elevate Credit, Inc., Think Finance provided both online loan products and lending technology services.

Provided with a $90 million credit facility from Victory Park Capital Advisors in 2010, the company originated more than 2 million loans for a total of over $4 billion. Having been ranked 2nd on the Forbes' "America's Most Promising Companies" list in 2013, the company proudly claims to have *"weathered the credit storm"* and believes its *"success speaks for itself."* While doubtlessly true given the company's emphasis on top line growth, it came with a hefty price.

Was the spin-off solely motivated by business fundamentals? Before taking the official business restructuring explanation for granted, there are multiple past developments at Think Finance that should be paid attention to. Here is a brief summary:

1. For years, TFI and its partners have been engaged in lending businesses involving rent-a-tribe and rent-a-bank schemes used to bypass state interest rate caps and regulations. Most recently, TFI and VPC have cooperated on a payday loan venture involving a Chippewa Cree tribe-owned Plain Green, LLC. With financing from VPC and outside investors, and loan analytics from TFI, the tribe would receive 4.5% of the revenues for underwriting the loans (see Appendix 1 for more details).
2. Elevate Credit spin-off happens in May 2014. Ken Rees, the former CEO of Think Finance, becomes the CEO of Elevate.
3. While the company's lending product portfolio - including RISE, Elastic and Sunny brands - is subsequently transferred to Elevate, the above-mentioned tribal lending and rent-a-bank schemes are not.

4. To a certain extent, the spin-off masks Elevate's involvement in certain deeds of its former parent company, effectively guarding the company and its key executives from future reputational damage.
5. Multiple lawsuits follow in 2015-2017. Ken Rees (Elevate CEO), Think Finance, Inc., its business partner Victory Park Capital Advisors, LLC and their affiliates appear in the following cases:

- Ken Rees, Think Finance, Inc. and Victory Park Capital Advisors, LLC and their affiliates are defendants in Commonwealth of Pennsylvania v. Think Finance, Inc. et al. (Case 2:14-cv-07139-JCJ);
- Victory Park Capital Advisors, LLC, GPL Servicing, Ltd. (a business partnership between Victory Park and Think Finance) and their affiliates are defendants in Gingras v. Victory Park Capital Advisors, LLC, et al. (Case 5:17-cv-00233-gwc). Think Finance, LLC. and Ken Rees are listed as interested parties;
- Ken Rees and Think Finance, Inc. appear as defendants in Gingras v. Rosette (Case 5:15-cv-00101-gwc);
- Think Finance, LLC is a defendant in Consumer Financial Protection Bureau v. Think Finance, LLC (Case 4:17-cv-00127-BMM);
- Ken Rees, Think Finance, Inc. and GPL Servicing, Ltd. are defendants in Banks v. Rees et al. (Case 8:17-cv-02201-SDM-AAS);
- Ken Rees, Think Finance, Inc. and GPL Servicing are defendants in Gibbs v. Rees et al. (Case 3:17-cv-00386-MHL).

6. Finally, a month before getting sued by the Consumer Financial Protection Bureau, Think Finance, LLC (previously TFI) files for Chapter 11 bankruptcy protection.

Now, let's have a more detailed overview of TFI's bankruptcy. On October 23, 2017, Think Finance, LLC, collectively with 6 affiliated entities, filed Chapter 11 with the United States Bankruptcy Court in the Dallas Division of the Northern District of Texas (Case 17-33964-hdh11). To summarize the case, the filing stated that Think Finance has been cut off from its key revenue streams by Victory Park Capital Advisors, LLC ("VPC" or "Victory Park"), a privately held Chicago-based global alternative investment firm. To quote the official declaration of Barney C. Briggs, CFO (page 3 in the filing):

"While Think Finance had intended to leverage its successful track-record and explore opportunities for continued growth and innovation in the fast-moving fintech industry, it has been forced to seek bankruptcy protection because of a liquidity crisis caused by hedge fund Victory Park Capital Advisors, LLC ("Victory Park"). Victory Park has caused GPL Servicing, Ltd. ("GPLS")-an entity that owes Think Finance and its subsidiaries tens of millions of dollars-to stop paying Think Finance for its services and Victory Park has raided GPLS's bank accounts. The scheduled payments from GPLS that Victory Park has intercepted represent a major component of Think Finance's near-term cash flow. Without these funds, Think Finance soon could be forced to cease or substantially curtail its operations. In fact, shortly before the bankruptcy filing, Victory Park's seizure of funds forced the Debtors to terminate 31 employees-a third of their workforce-and incur substantial severance obligations."

For an in-depth overview of Think Finance bankruptcy and the events preceding it, please see Appendix 1. Summing it all up, the official version of Think Finance's breakup with Victory Capital sounds like a complete disaster. Let's consider this situation from another perspective, however.

As was noted before, by the time of the bankruptcy filing, Think Finance and Victory Park were facing a number of pending litigations in relation to Plain Green's payday loan business. Should something go wrong, which it did, Think Finance was set to take the one for "the team" (i.e. Victory Park and outside investors). Not only did it effectively subordinate its participating shares, but it also had substantially all of its assets pledged to Victory Park. Although the operating structure positioned Think Finance as service provider rather than a lender, its involvement didn't go unnoticed in court. It thus doesn't come as a surprise that the Collateral Agent - 100% controlled by Victory Park - had swiftly cut Think Finance off the money once the lawsuits came knocking.

8. Elevate's current loan brands bear significant similarities with Plain Green, implying a notable exposure to future lawsuit risk. Pennsylvania lawsuit demonstrates that regulators are already noticing Elevate CEO's history with running lending practices that attract regulatory attention.

So, what went wrong? Why the lawsuits? The key focus of the lawsuits are illegal lending practices and usurious interest rates. The following excerpt from the Pennsylvania lawsuit pretty much summarizes the situation:

"The OAG alleges that the Defendants ***partnered with an out-of-state bank and with Native American tribes, in schemes known colloquially as "rent-a-bank" and "rent-a-tribe."***

In the alleged "rent-a-bank" scheme, the Think Defendants and Mr. Rees partnered with First Bank of Delaware ("FBD"), an out-of-state bank […] FBD acted as the nominal lender while the non-bank entity was the de facto lender - marketing, funding, and collecting the loan. […] This partnership took advantage of federal bank preemption doctrines to insulate the Defendants from state regulations. […] The "rent-a-tribe" scheme similarly avoided state laws by issuing loans in partnership with Native American tribes […] The tribe acts as the nominal lender and the Defendants benefit from the tribe's immunity […] The OAG alleges that the Think Defendants and Mr. Rees are themselves the de facto lenders and that their partnership with the tribes, as the partnership with FBD previously, is meant to provide cover as the Defendants violate Pennsylvania and federal law."

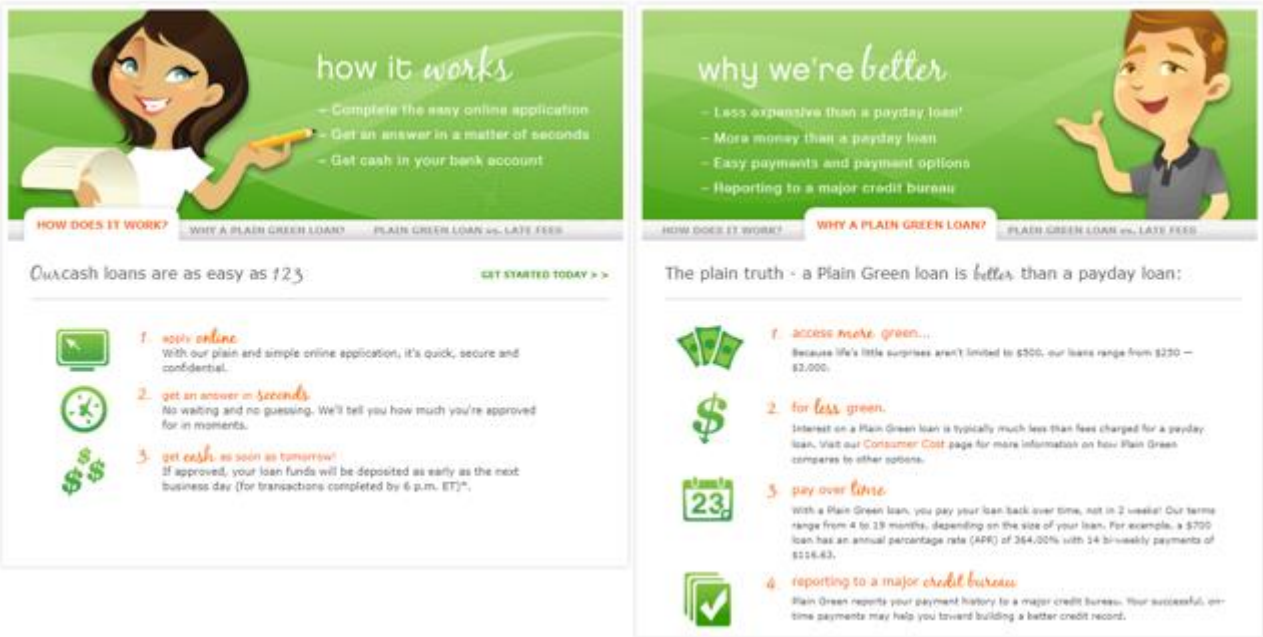
In part, the lawsuits are also based on the fact that ***Rees and Victory Park have already had one payday lending business face regulatory scrutiny - hence the decision to employ tribal immunity.*** As explained in Gingras et al v. Victory Park Capital Advisors, LLC et al, ***the tribal lending enterprise Plain Green***

"was created when Defendant Victory Park and Kenneth Rees, the masterminds of this illegal scheme, saw Rees' s former payday lending business, ThinkCash, shut down by federal regulators.*Victory Park and Rees were undeterred by this setback and sought a new way to prey on unsuspecting people. Rees and Victory Park believed that cloaking their Victory Park, Haynes, Rees, and Think Finance would provide everything the Tribe needed to run a successful payday loan enterprise and micromanage the enterprise if the Tribe would let them exploit the concept of tribal immunity to stymie state and federal regulators. In return, the Tribe would receive 4.5% of the revenues*."

A summarized outline of the agreement for Think Finance-Chippewa Cree Transaction is available here, ***apparently signed by the current Elevate COO Jason Harvison***.

As seen in the screenshots below, the value proposition of Plain Green loans had much in common with Elevate's products. The key selling points were:

- Cheaper that a payday loan;
- Reporting to a major credit bureau;
- Easy online application;
- Get an answer in seconds;
- Cash as soon as tomorrow;
- Easy payments and payment options.



Excerpts from the plaingreenloans.com website on Jun 10, 2015. Source: captured via WayBackMachine.

Somewhat similar to Elevate, Plain Green touted its flexible payment schedules and promoted loans that *"are designed to help you meet your emergency borrowing needs."* In contrast, the above-mentioned Gingras lawsuit

claimed that the loans were actually structured as to avoid quick repayment. Requiring the borrowers to consent to ACH (Automatic Clearing House) withdrawals to minimize non-payment, the company sometimes even *"blocked borrowers' access to their Plain Green accounts so that the borrowers cannot determine what they have paid."*

What's changed since then? Readers expecting that the days of Think Finance management's cooperation with Victory Park Capital are long gone might be terribly mistaken. Consider the following:

- VPC continues to provide the majority of financing for Elevate. With a Debt/Equity of 5.3, its dependence on the investment firm remains quite notable.
- All of Elevate's assets are pledged to secure its credit facilities with Victory Park Capital.
- Tom Welch, a partner at Victory Park Capital who spoke on the phone with the Think Finance CFO during its falling-out with VPC, is now quoted in press release updates on Elevate's credit facilities with the investment firm.
- Ken Rees remains the key connection with Victory Park up until this day. From the 10-K: *"…In the event we lose Mr. Rees' services, we could face an event of default under the VPC Facility."*
- Same management, same building. As seen on CrunchBase, key executives (CEO, CFO, General Counsel) that led the Think Finance operation have the same roles at Elevate. Jason Harvison, who signed the agreement for the Think Finance-Chippewa Cree Transaction, is now the COO.
- The rent-a-bank scheme appears to be on once again. This time, with Republic Bank & Trust Company (NASDAQ:RBCAA).
- There are notable positioning and marketing similarities between Elevate loan brands and Plain Green.
- Lawsuits concerning both parties (and Elevate CEO) remain active.

9. Elevate's historical growth is built on expansion in credit facilities offered by VPC. With a Debt/Equity of 5.3 and multiple loan book quality covenants, equity holders may be long the bottom tranche of Elevate's portfolio, which - in addition to substantially all of its assets - is pledged to VPC to secure the funding. Should the 3-month principal charge-off rate exceed 20%, VPC would be able to accelerate the debt. It was 16% in Q1 2015.

"The main thing that the IPO does for us is reduce our reliance on debt financing. Victory Park Capital has been a terrific partner but that debt isn't free. Raising money in an IPO will support growth and drive down our cost of capital." - Ken Rees in a Tech Crunch article.

"We will use approximately $14.9 million of the net proceeds to repay a portion of the outstanding amount under our convertible term notes, approximately $53.0 million of the net proceeds to pay down or pay off the ELCS Sub-debt Term Note, the 4th Tranche Term Note and the UK Term Note outstanding under the VPC Facility and the remainder, if any, for general corporate purposes, including to fund a portion of the loans made to our customers." - from the "Use of proceeds" section in the 7th S-1/A filing.

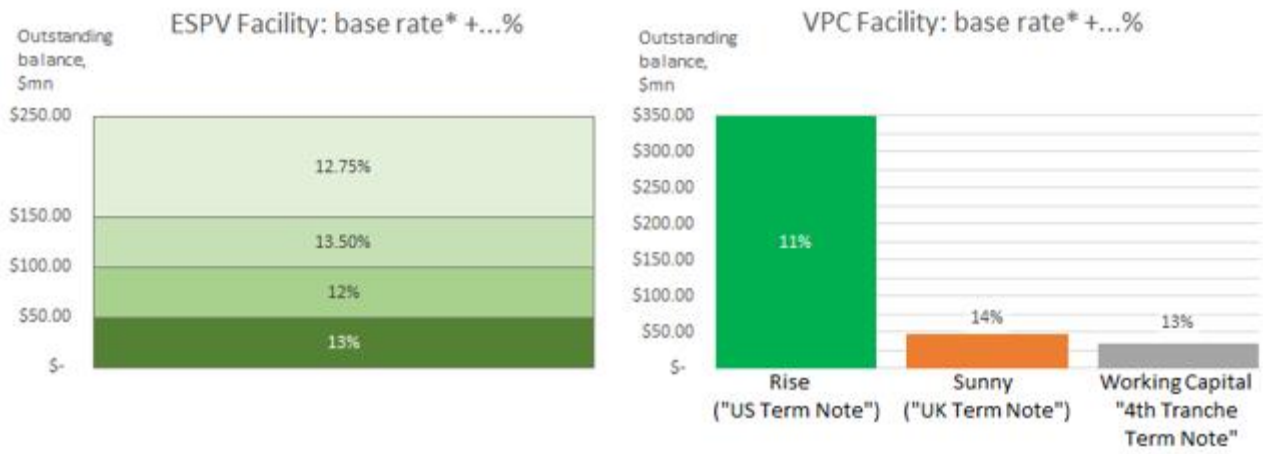
Despite the company's voiced intentions to reduce its debt burden and reliance on VPC, its operating structure suggests otherwise. The foundation of Elevate's loan underwriting is based on two credit facilities from VPC:

- The VPC Facility is divided into three term notes funding Rise, Sunny and company's working capital needs;
- The ESPV Facility is used to fund Elastic, company's fastest-growing loan product.

Given low free cash flow generation over the entire reporting history, ***Elevate's historical growth is almost exclusively a product of debt***, prompting a Debt/Equity increase from 3.35 at the end of 2014 to 5.34 in 2017. Per the data from S-1 and the latest 10-Q filing, total notes payable to VPC have recently tripled to $525.3mn from $174.8mn as of the end of 2014.

Both facilities have already been increased and extended a couple of times, with the current maturity dates set for February 1, 2021 (VPC Facility) and July 1, 2021 (ESPV). Although the interest rates have seen a couple of downward readjustments over the years, the debt doesn't come cheap.

The current credit facility distribution by cost and use is summarized in the diagram below. The ESPV facility's interest rate depends on the outstanding balance, whereas the VPC facility's rates vary by term note. In 1H 2018, effective cost of funds under the VPC and ESPV facilities stood at 15.2 and 15.1 percent, respectively, for average facility balances of $296.2 and $215.6 million.



The base rate is the 3-month LIBOR with a 1% floor.

Made by the author. Source: company's filings.

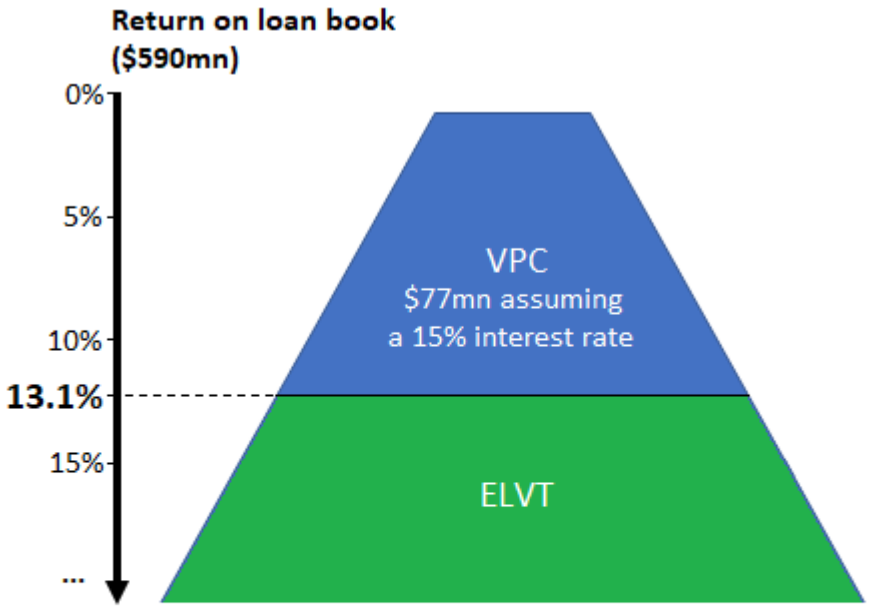
With Elevate bearing most of the risks, its business structure essentially allows VPC to have a (relatively) safe return on the company's loan book. Similar to Think Finance's Plain Green operation, all of Elevate's assets are pledged to secure the two facilities with VPC (see p. 70 and 71 in the most recent 10-Q). Applicable covenants include the following:

- A maximum loan-to-value ratio of 0.75-0.85, subject to the charge-off rate as of the applicable measurement date;
- For any given month, 1st payment default rate may not exceed 20%. In any 3-month period, no more than one month may have a rate exceeding 17.5%.
- ***Principal charge-off rate may not exceed 20%.*** The rate is calculated as a ratio of principal charged-off/past due to current and delinquent principal, measured for the last three months starting from the charge-off month.
- A minimum corporate cash balance of $5mn. A minimum book value of equity value of $5mn at the end of each month.

So, what could hypothetically happen in a case of recession? Despite the success with more recent vintages, cumulative loss rates are below the lower bound of the targeted 25-30% range. Should they mean-revert and thus accelerate in the future years (a turn in the business cycle?), charge-off rates may become a problem.

ELVT bulls may disagree with me here, arguing that recent compression in cumulative loss rates is here to stay and reflects the company's technological edge and achievement. Before taking that leap of faith, however, one should be aware of Elevate's own stance on the charge-offs: *"Although a more seasoned portfolio will typically result in lower net charge-offs as a percentage of revenues,* ***we do not intend to drive down this ratio significantly below our historical ratios*** *and would instead seek to offer our existing products to a broader new customer base to drive additional revenues."* Since the historical sample is quite short (and the management's experience isn't), one might want to pay the 25-30% range more attention. Thus, with occasional breaks from the historical target range like the current one, I would expect that a move above the upper range in cumulative loss rates is still possible at certain conditions. ***Investors shouldn't forget that Elevate's principal charge-off rate totaled 16% in a relatively calm first quarter of 2015*** *(which is, in fact, the oldest available figure).* ***At or above 20%, Elevate may find itself in breach of at least one of its debt covenants.***

Thus, summarizing my tranche argument, Elevate's annual return on the loan book needs to be at least 13.1% to break even after the interest payment on VPC facilities (assuming combined loans receivable figure for Q2 2018 and a fixed 15% interest rate). That's also before all other costs - including CACs, provisions and administrative expenses - and Elevate's business risk. If the loan book quality goes south and results in a technical default due to covenant violation, VPC will have an acceleration right (section 10.2, 10-K, exhibit 10.79) and may seize the collateral. For a more detailed diagram based on the principal charge-off rate covenant, please see Appendix 2.

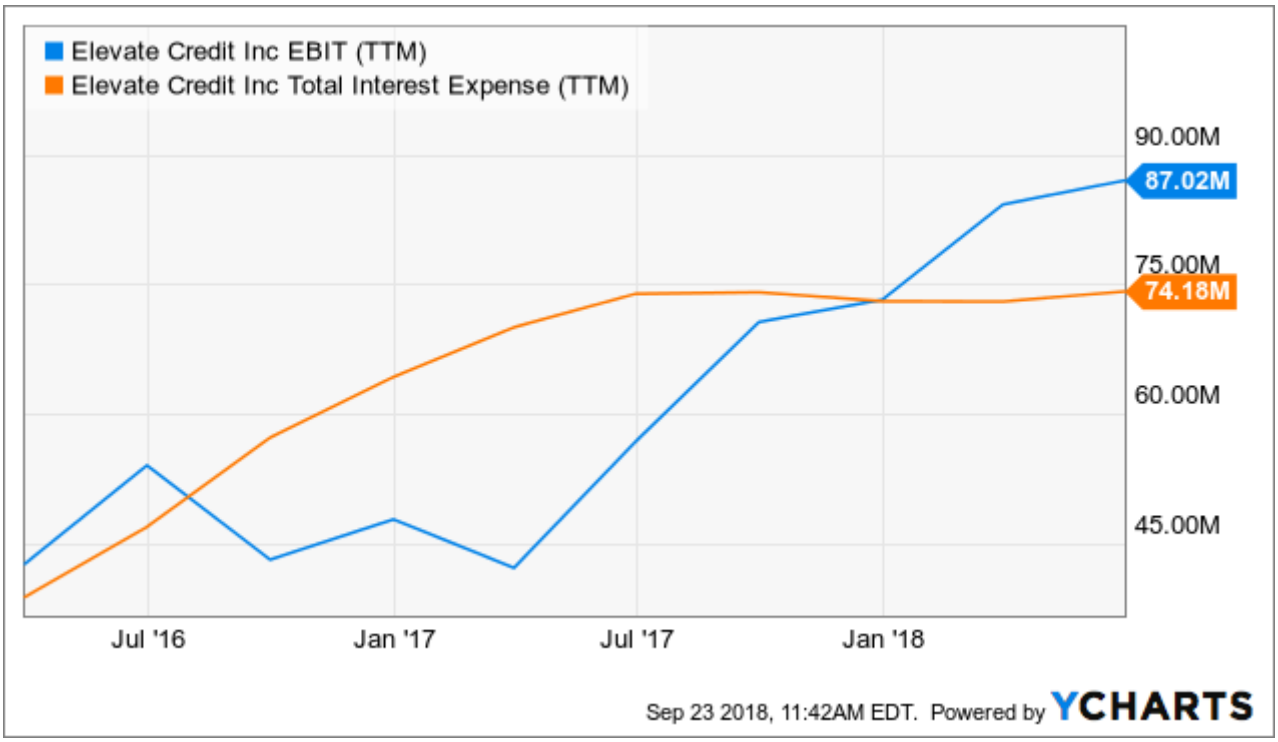


Assumes:
1) an average 2018 facility balance equalling the first 6 months' figure of $512mn (since average balances were roughly the same for 1H 2017 and full 2017);
2) a 15% interest rate (mentioned by the ELVT CFO during the Q2 earnings call) resulting in an annual interest payment of $77mn.

The 13.1% rate is calculated as the annual VPC facility interest payment divided by the latest combined loans receivable figure of $590mn. Does not include any other costs, including loan loss provisions, CACs and various administrative and corporate expenses.

An approximation of ELVT shareholders' breakeven point on the loan book. All figures are approximated as the actual figures may differ significantly due to fluctuations in ELVT's loan book, debt and USD Libor rates. Source: made by the author using the data from company's filings.

As demonstrated by historical trends in the chart below, company's EBIT has mostly been struggling to stay significantly above the VPC interest payments to date.



ELVT EBIT (TTM) data by YCharts

Let's now shift our attention to Elastic. As a potential source of future regulatory risk, its operating structure is worth putting additional emphasis on.

10. Elastic loan brand may serve as a future risk. Its operating structure resembles that of ThinkCash, a Think Finance predecessor which partnered with First Bank of Delaware before the latter has been essentially shut down by the FDIC. Despite a continuously stated expectation of a new Elastic funding source, the company has a sophisticated financing scheme with VPC.

"Years ago, regulators put a stop to rent-a-bank arrangements used by payday lenders. Yet history repeats itself, and rent-a-bank payday lending is once again rearing its head in the guise of fintech and innovation." - from a National Consumer Law Center email to the OCC.

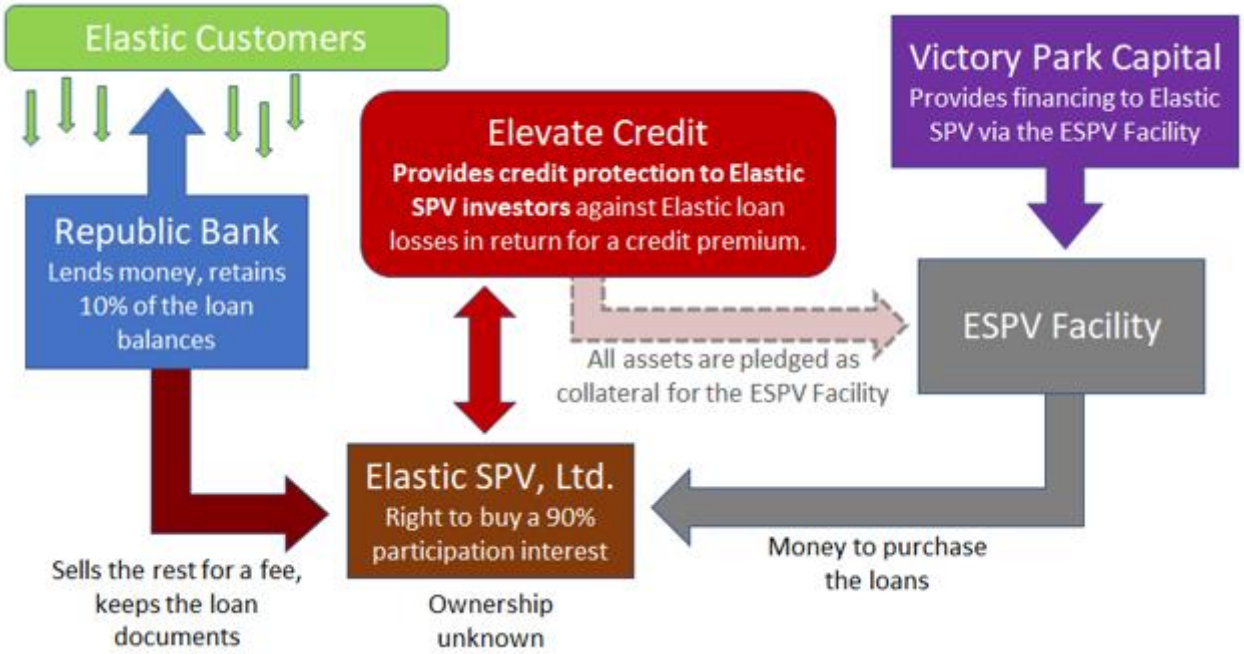
"We see a competitive advantage in having products that operate under diverse regulatory frameworks." - Elevate CEO at the Q2 earnings call.

Despite having effective APRs of approximately 100%, Elastic operates in multiple states with lower interest rate caps (e.g. Arkansas with 17%). That is made possible via a bank partnership and the use of carried balance fees instead of interest. As mentioned in the email referenced above, *"The Truth in Lending Act rules for calculating APRs on open-end credit are full of loopholes and might even result in an APR of 0% for the Elastic loan if the fees are not considered to be periodic interest.*" ***Whether based on loopholes or not, Elastic is claimed to be a fee-based product with no periodic rate that would require APR disclosure*** in the 10-K. The product is thus excluded from an "APR by geography" table comparing the products' APRs with the limits set by individual states.

The last time Ken Rees ran a rent-a-bank scheme was with ThinkCash back in early 2000s. After a regulatory crackdown in late 2000s, the company promptly rebranded itself as Think Finance and sent a letter to the Chippewa Cree Tribe in early 2011. As sovereign immunity failed to stop a new wave of lawsuits, the next Rees-led company revamp transformed it into a fintech.

The Elastic product is provided in partnership with Republic Bank & Trust Company, known for being urged to end its payday loan business by the FDIC in 2006. Up to this day, the bank is no stranger to being strongly criticized for its lending practices in customer reviews (see here and here).

Even though Republic is responsible for the service and provides the initial financing, its key role may be to help Elevate avoid the state usury caps. Similar to Think Finance's Plain Green operation, Elastic positions the company as a service provider. Whereas Elevate would be subject to state usury laws as a lender, Republic is only required to comply with its home state regulation. With customer acquisition and credit assessment done by Elevate via licensed software and additional services, Republic's participation is limited at 10%. After the loan is issued, the rest is sold to Elastic SPV, Ltd. ("Elastic SPV") - a Cayman entity with a right to purchase a 90% participation interest in the loan balances. Since Elevate doesn't technically own Elastic SPV (its ownership is not disclosed), the two have a credit protection agreement. In exchange for protecting the Cayman entity investors from loan losses, the company is paid a credit premium. As discussed previously, Elastic SPV is funded via the ESPV Facility kindly provided by Victory Park Capital.



Made by the author. Source: company's filings.

Should Elastic face regulatory scrutiny in the future, there may be reasons to expect a complication in Elevate's business with Republic, which in its turn would put the origination of its largest loan brand at risk. With its stock near a record high, the bank has a diversified business structure. It does not mention the product in its SEC filings and, if pressured, may be tempted to forget about its rent-a-bank scheme with Elevate.

Meanwhile, in a possible effort to dissuade investors' concerns over the VPC debt, company's filings constantly feature an expectation of diversified financing for Elastic. Despite always being suggested to arrive pretty soon, it constantly fails to materialize:

"[...] We expect an additional SPV will be created as another funding source for the Elastic line of credit product. This additional SPV for Elastic would provide additional funding, diversified funding sources and further lower the cost of funds."

Q1 2017: *"During the second quarter of 2017"*
Q2 2017: *"Subsequent to the third quarter of 2017"*
Q3 2017: *"During or shortly after the fourth quarter of 2017"*
2017 10-K: *"Early in 2018"*
Q1-Q2 2018: *"During 2018"*

Made by the author. Source: company's filings.

Whichever perspective you choose, the single most important factor to Elevate's stock price right now is its reputation. ***As explained in Appendix 3, a possible disconnect between ELVT's public image (a proponent of brighter financial future) and the actual terms faced by its customers may add to the future lawsuit risk.***

11. Company's loan brands rely on a number of regulatory loopholes discussed below. Putting significant emphasis on adjusted EBITDA is not exactly fitting for a lender.

The company's business hasn't exactly changed after the company decided to jump on the fintech bandwagon. As a reminder, Think Finance has already deployed its data-driven software to lead loan originations in its partnership with VPC and Plain Green, so it doesn't seem as if the company's business has experienced a full revamp since

then. What's changed, however, is that the company uses its new fintech status to lobby regulators for supporting financial innovation. Let's take another look at Elevate's financial innovation.

To bypass the allowed APR caps in Tennessee and Kansas, Rise is offered as a line of credit. For example, the statutory maximum APR allowed in Tennessee totals a periodic interest of 24% per annum and a 0.7% daily fee on the billing cycle's average daily balance. Including fees, the maximum offered APR by Rise line of credit in that state (275%) is, per 10-K, *"actually the periodic interest and fees allowable by statute."*

As discussed earlier, questionable justification for not disclosing Elastic's APRs due to the line of credit being fee-based might pose additional regulatory risk in the future. No matter how you describe it, the carried balance fee may still be viewed as an innovative way to charge interest on the outstanding principal. As an example, here's an excerpt for Elastic's carried balance fee structure for carried balances in the $1,500.01-2,500.00 range:

Carried Balance ("CB")	CB fee, bi-weekly/semi-monthly payment	CB fee, monthly payment
$1,500.01-1,750.00	$65.00	$130.00
$1,750.01-2,000.00	$75.00	$150.00
$2,000.01-2,250.00	$85.00	$170.00
$2,250.01-2,500.00	$95.00	$190.00

Source: Elastic Terms and Conditions.

To comply with anti-usury laws and offer Rise in certain states like Ohio and Texas, the company operates as a credit service organization servicing the loans originated for it by third party lenders and earns "CSO fees" instead of being paid interest.

Whether a fintech or not, the company remains first and foremost a lender. The value of Elevate's data software is up for a debate. However, with or without sophisticated technology, Elevate remains a lending business dependent on interest income streams. It can thus be argued that starting off the earnings calls by discussing adjusted EBITDA growth and adjusted EBITDA margin during the CEO's introductory speech is fairly unconventional in that context. While opinions may vary, it may be hard to see the metric as a proper value-add and not a distracting factor.

12. Company's recession-proof evidence may not be as solid as it may seem. Elevate's effort to portray itself as a counter-cyclical investment involves a number of data representation methods one may find questionable.

Pitching the company's prospects for an IPO wasn't that simple. After delayingits IPO in early 2016, the company finally went public in April 2017 after cutting its pricing to $6.50 a share vs. $12-14 expected by analysts. Following subprime concerns and charge-off rate questions in a CNBC interview on the IPO day, the company's presentations began to emphasize the low volatility of non-prime loan delinquency (see p. 12). In Rees' own words,

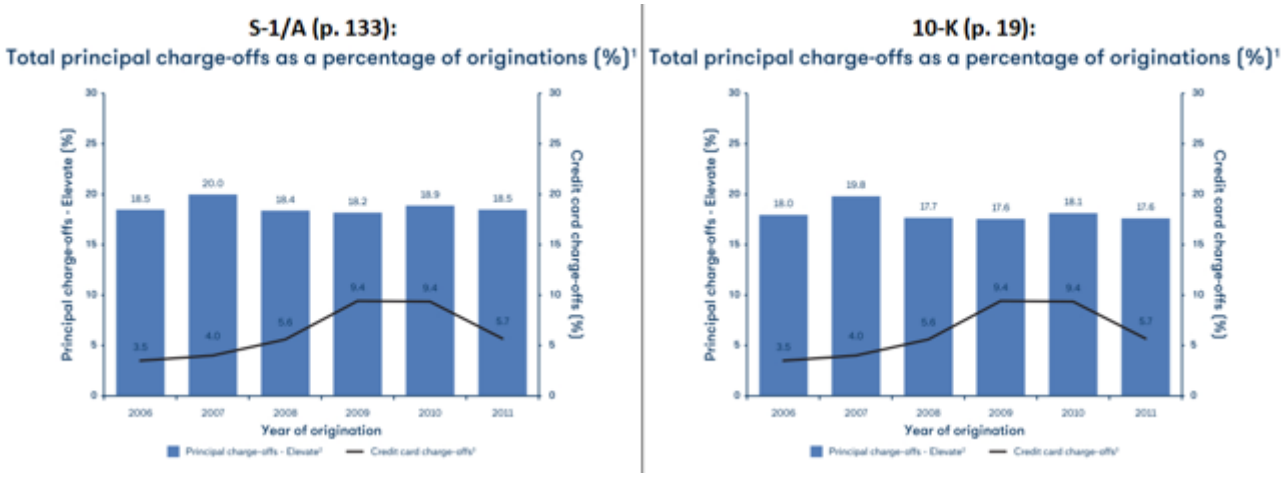
"We've experienced - and we are unique in the world of fintech - that we actually were lending through the last recession. And we actually saw incredibly consistent charge-off rates year in and year out, unlike the rest of the credit world, so we believe that our experience for unsecured credit to our space is actually counter-cyclical, and a great hedge against any future volatility in the market."

After being countered with an anchor's opinion that ***the description was counter-intuitive to seemingly any lending practice***, he added,

"It is. What we find is that our customers are somewhat recessionary all the time - they're used to dealing with the world where they have maybe less savings, more income volatility - they get through."

So, with an intent to create a sense of assurance, company's latest presentations never go without a slide emphasizing that Elevate legacy predecessor's charge-off rates were more than just stable before and after the Great Recession. See the latest presentation here for an example (p. 11).

While impressive, the data should be taken with a grain of salt. Why? First of all, legacy predecessor figures available in the presentations and the latest S-1 (average of 18.75%) appear to differ from the ones seen in 10-K (average of 18.13%):



Source: company's S-1/A (p. 133, filed 4/6/17) and 10-K (p. 18, filed 3/19/18) filings. Even if it's assumed that the historical figures may have been adjusted due to collections (hence the higher figures in the earlier filing), one should note that April 18 and Aug. 18 presentations (p. 11) continue to demonstrate the figures seen in the S-1.

Secondly, all of Elevate's existing brands only date as far back as 2013, and the entire S-1 registration filing focuses on the current brand portfolio only. At $22.5mn in combined loans receivable as of Q3 2013, its beginnings were rather humble in comparison with the latest figures ($623.8mn). ***It thus may be somewhat misleading to list charge-off rates of a "legacy predecessor" for which no additional data is given.*** A couple of additional reasons the company doesn't really want to discuss its predecessor's operations will be discussed later.

Furthermore, the chart makes an apples-to-oranges comparison for two reasons. As explained in the footnotes, figures for credit card debt are apparently sourced from FRED's data series on credit card loan charge-off rates for all commercial banks (annual). Curiously enough, the chart compares these data with legacy predecessor's principal charge-offs *by year of origination*. ***Comparing predecessor's principal charge-offs for loans originated in a particular year (e.g. 2007) with banks' total net charge-offs (any vintage) in 2007, as well as presenting both data series on a date axis titled "Year of origination" may thus be simply confusing and wrong.*** Secondly, per FDIC's Expanded Guidance for Subprime Lending Programs, credit loss estimates "should include accrued interest and other accrued fees." ***By excluding accrued interest and instead choosing the (lower) net principal charge-offs, the comparison may give the legacy predecessor an unfair advantage.*** Finally, if investors are to believe that the figures are a good indication of future results, why is it that ***predecessor's recession figures are actually below the recent cumulative loss rates reported by Elevate***?

Elevate's recession-proof pitch might not be as bulletproof as it may appear on the surface. As to reiterate its argument, the company uses another presentation slide with a strong headline and a confusing statistical meaning (see p. 12). Stating "Non-prime lending is the least volatile sector," the slide features a diagram with personal loan delinquency volatility for different rating cohorts. The same illustration may be found in the 10-K (page 20) under the name *"Personal loan delinquency volatility **through** the Great Recession."* The latest presentations' slides, however, call the same chart *"Personal Loan delinquency volatility **after** the Great Recession 2006-2017,"* although it is unclear what that's supposed to mean.

From the 10K:

"As shown in the following chart, according to TransUnion data, non-prime portfolios demonstrated approximately half of the charge-off rate volatility of Prime, Prime-Plus and Super Prime portfolios during the Great Recession between 2006 and 2011. We believe this indicates that patterns of credit charge-offs for non-prime consumers can be acyclical or counter-cyclical when compared to prime consumers in credit downturns."

Is that so? The metric used in the chart is the coefficient of variation, a metric that's commonly used for comparing historical variance among variables of different nature (e.g. comparing weight variability between apples and oranges). Dividing standard deviation by the mean, ***the coefficient is useful for making conclusions for the***

entire sample, not particular areas of it. In this example, the standard deviation and the mean are effectively normalized over the calm days of the current and previous cycles. Given that the data span from Q1 2006 to Q1 2017, The final coefficients are thus useful for comparing tiers' delinquency volatility in 2006-2017. ***Their use for the recession-proof pitch may be viewed as rather inappropriate***, however (curious choice of starting and ending points could have also contributed to the results).

13. A lender's or a tech company's valuation multiple? A loan book risk-based comparative valuation signals potential for a significant downward repricing. Given the low short interest levels in comparison with a less risky name in the sector, the market may not be aware of ELVT's risks yet. The growth rate incorporated in the stock price may not be sustainable.

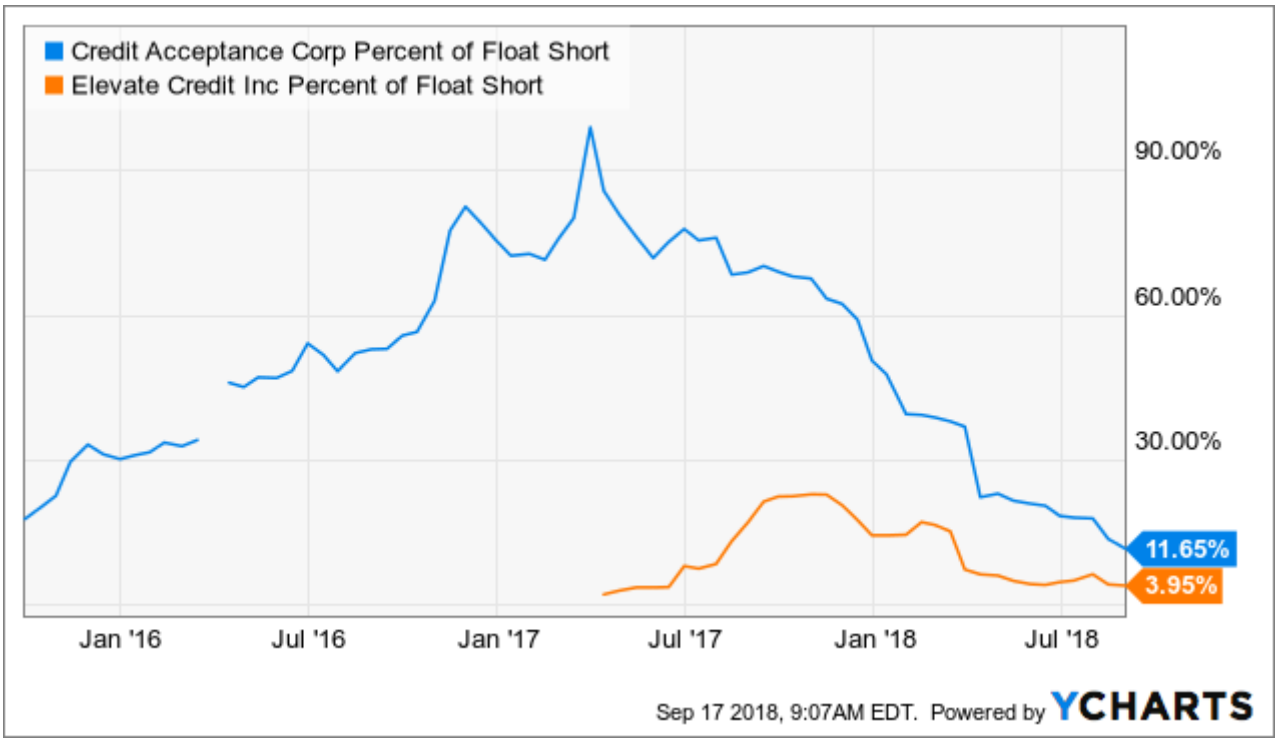
With a targeted loan loss provisions range of 45-55% of the revenue (10-K, p. 78) and expressed comfort with the current charge-off rates, Elevate's future profitability is more a function of APRs and CACs than of technological edge.

As a lender, the company should also be probably valued as a lender. Taking into account the level of loan book's risk, the stock is fairly richly valued in comparison with companies recognized for their exposure to riskier subprime and non-prime loans.

	ELVT	SC	WRLD	CACC
Price/Book	3.25	1.10	2.09	4.80
Provision for Loan Losses to Revenue	53.12%	42.81%	23.87%	11.75%

Source: made by the author using the data from companies' filings and Finviz. Due to GAAP accounting specifics, ELVT's book value includes loans held by Elastic SPV, which it doesn't technically own.

Peak short interest as a percentage of float for Credit Acceptance Corporation (CACC), a heavily shorted name due to its valuation and subprime auto loan concerns, significantly outmatches that of Elevate's historical figures, leading me to conclude that the market may not be aware of the company's fundamentals just yet. Per WSJ data, latest percent of float short figures for CACC and ELVT are 9.1% and 5.9%, respectively.



CACC Percent of Float Short data by YCharts

Given that the majority of Elevate's recent growth was driven by debt, the company may not be able to grow its free cash flow at a rate the price may incorporate. A simplified DCF analysis assuming $20mn in 2018 FCF, a beta of 1.28 (S&P 500), risk-free and terminal growth rates of 3%, effective tax rate of 21% and an equity risk premium of 4.68% (per Damodaran) ***estimates that ELVT's current valuation prices in a 35% growth rate over the next 5 years. Considering the risk presented by the company's loan book, however, it may be fair to assume that the stock's valuation is likely to move towards a Price/Book of 1-1.50, taking into account the company's technology.*** Over the medium term, this would imply a potential downside of 53-69%.

14. Mixed consumer review data may offer an incomplete picture on customer satisfaction. Trustpilot review scores may have been influenced by cherry-picking the customers that are offered to publish a review.

A proponent of brighter financial future or just a profiteer? Despite successful marketing and PR, various aspects of Elevate's loan brands resemble payday loan features, as further described in Appendix

Elevate's inspiring and upbeat promotional materials are oftentimes in contrast with actual customer reviews. Although a portion of reviews available on the Internet may be fake, it's still worth mentioning that Elastic and Rise reviews are typically either very positive or outright negative. Notably, As seen in a CreditLoan.com review of Rise dated April 21, 2017, Credit Karma's score on Rise was 1.7/5 with 52 reviews. As of this writing, however, the score totals 4.1 with 227 reviews. For unknown reason, the number of review platforms featuring Rise significantly exceeds that of Elastic.

Trustpilot, which ranks among the largest review sources for Rise and Sunny, has a notable number of ratings published by users with only 1 published review. After sifting through the first 20 pages of 5 star reviews for both loans, it quickly becomes obvious that the overwhelming majority of "Excellent" scores come from users with a "Verified order" icon, which is exactly the opposite for the "Bad" and "Poor" scores. Could it be the case that the quickest customers to pay off their loans are automatically offered to publish a Trustpilot review? It's not a secret that Internet reviews is an increasingly discussed subject with a growing number of methods and tricky techniques involved. Running through 1-star Trustpilot reviews on Rise and starting with the older ones, one will quickly notice that the majority of reviewers commonly had a "Verified order" status up until mid-June 2018, when the frequency of negative reviews from verified customers started declining.

- LendingTree - Elastic (4/5, 19 reviews);
- LendingTree - Rise (4.4/5, 95 reviews);
- Supermoney.com - Elastic ("Mostly not recommended," 63 users not recommending, 30 recommending users and another 6 are unsure);
- Supermoney.com - Rise ("Mostly not recommended," 26 users not recommending, 18 recommending users and another 7 are unsure);
- Credit Karma - Rise (4.1/5, 227 reviews);
- HighYa.com - Rise (3.6/5, 129 reviews);
- Trustpilot - Rise ("Great," 76% excellent, 10% great, 3% average, 2% poor and 8% bad, 1037 reviews);
- Yelp - Rise (1 out of 5 stars, 27 reviews);
- Pissed Consumer - Rise (2.2/5, 211 reviews);
- Trustpilot - Sunny ("Excellent," 84% excellent, 8% great, 2% average, 1% poor and 4% bad, 3446 reviews);
- Smart Money People - Sunny (4.9/5, 3823 reviews).

Common factors discussed in positive reviews are: fast, easy to apply, helpful customer service and various variations of a very popular phrase like "There when I needed them."

Common negative factors discussed: APRs, deceptive marketing, unhelpful customer service, website issues, identity fraud cases.

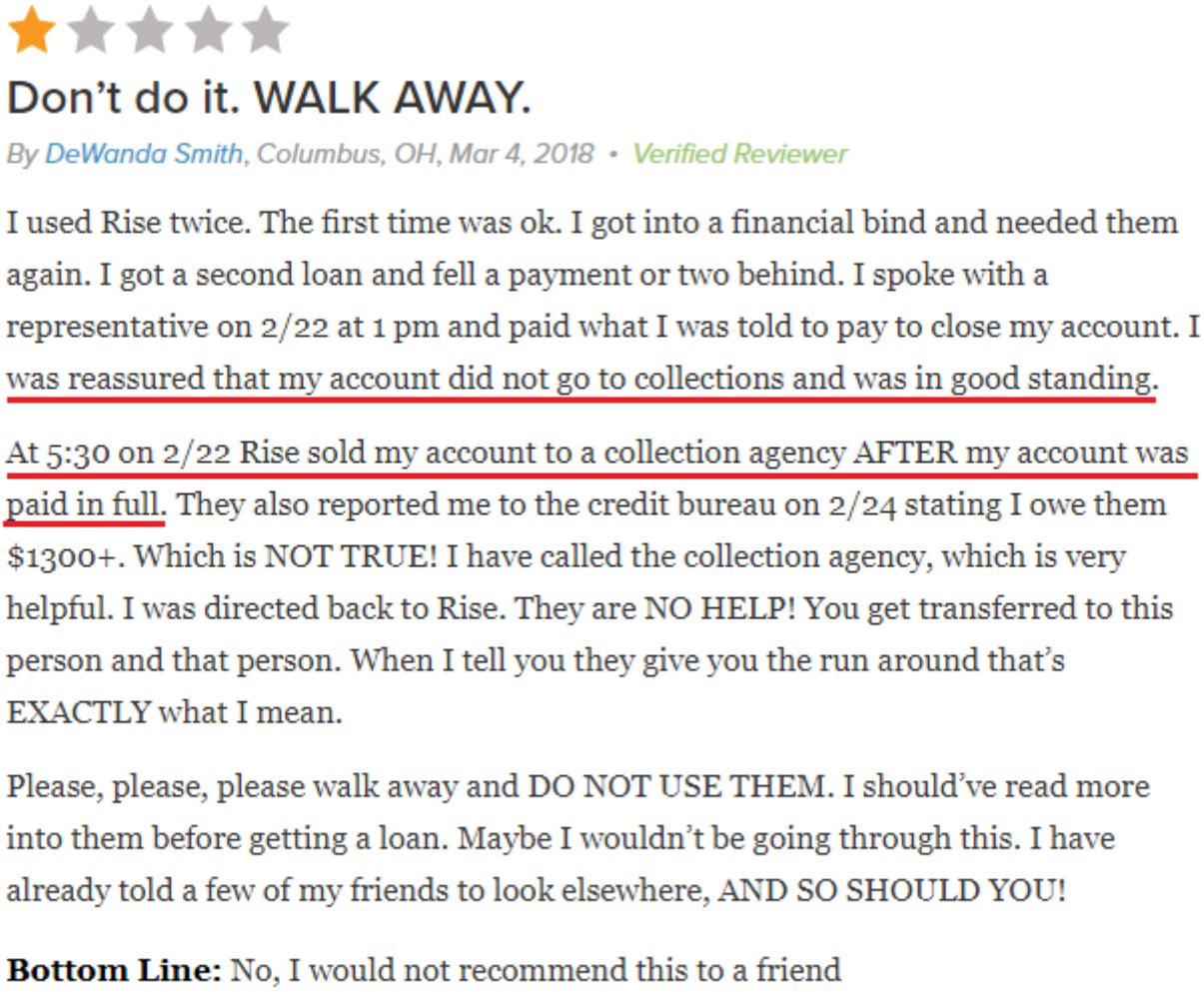
Another potential criticism from a consumer's point of view lies in the positioning of Elastic, which creates an impression that the consumer is better off paying down the loan slightly faster (see appendix 3).

15. Company's public stance on avoiding debt collection may create a false impression that it's advanced technology that allows Elevate to neglect collecting on delinquent loans. Outsourcing an activity and not doing it at all are two different things, however.

"We built up a lot of analytics and decided not to collect in any meaningful way. It is sort of lending on the honor principle." - Ken Rees for a Forbes article.

Mentioning that technology *"has allowed Elevate to change the way lending to non-prime borrowers can work*," Rees doesn't acknowledge the fact that debt collections are still in use. From the 10-K: *"We use third-party collection agencies to assist us with debt collection. Their failure to comply with applicable debt collection regulations could subject us to fines and other liabilities, which could harm our reputation and business*." One of the collection agencies employed by the company appears to be National Credit Adjusters, LLC, according to certain customer complaints. This company is also a defendant in the Pennsylvania lawsuit against Think Finance and Ken Rees.

According to an American Banker podcast with Rees, the company would typically call or send its past due customers an email similar to *"You're past due, and we would appreciate you paying us."* However, in reality the company seems to be much more active at using collection services:



Don't do it. WALK AWAY.

By DeWanda Smith, Columbus, OH, Mar 4, 2018 • Verified Reviewer

I used Rise twice. The first time was ok. I got into a financial bind and needed them again. I got a second loan and fell a payment or two behind. I spoke with a representative on 2/22 at 1 pm and paid what I was told to pay to close my account. I was reassured that my account did not go to collections and was in good standing.

At 5:30 on 2/22 Rise sold my account to a collection agency AFTER my account was paid in full. They also reported me to the credit bureau on 2/24 stating I owe them $1300+. Which is NOT TRUE! I have called the collection agency, which is very helpful. I was directed back to Rise. They are NO HELP! You get transferred to this person and that person. When I tell you they give you the run around that's EXACTLY what I mean.

Please, please, please walk away and DO NOT USE THEM. I should've read more into them before getting a loan. Maybe I wouldn't be going through this. I have already told a few of my friends to look elsewhere, AND SO SHOULD YOU!

Bottom Line: No, I would not recommend this to a friend

A Rise loan review highlighted by the author. Source: Highya.com

The company's motivation to adhere to its fintech status is clear, yet there may be a difference between noting that advancement in technology allows the company to avoid debt collection (thus implying that its tech is superior to the competition's) and essentially ignoring the fact that debt collection is simply outsourced.

16. VC firms remain among the largest shareholders of the company. Previous lawsuits and the general tendency to look for an exit strategy creates a risk of institutional selling pressure.

As of the latest 14A, approximately 31% of Elevate's common shares outstanding were held by venture capital firms Technology Crossover Management ("TCV") and Sequoia Capital ("Sequoia"). Both companies acted as early stage backers of Think Finance and, as a result, are featured in one of the lawsuits against it.

Since the VC investment process typically involves seeking an exit strategy either through a secondary purchase or an IPO, one may expect that the two firms may be seeking to lock in their gains in the future. With a relatively low institutional ownership of 58.76%, the market may have trouble finding a buyer for the firms' stakes in ELVT should the stock face increased selling pressure in the coming quarters.

After its director was removed from Elevate's board of directors in connection with a sexual misconduct scandal in 2016, Sequoia had its board seat replaced by Saundra D. Schrock. Per CNBC, Elevate CEO said that Sequoia "allowed her to be their official board representative."

John C. Rosenberg, who represented TCV, left the board on May 31, 2018. According to Rosenberg's LinkedIn, the departure appears to be motivated by a career change. His term was set to expire in 2019, and Elevate's board has no official TCV representatives at the moment.

17. The company may not be suitable for investors adhering to ESG or socially responsible investing practices, putting a potential constraint on future institutional ownership. Certain employee reviews note that the scores may have been influenced.

Despite the company's efforts to maintain a reputation of a responsible lender contributing to the financial wellness of a consumer, its public image is up for a debate. Even though the stock may undeniably pass the preliminary due diligence process at numerous funds, its ownership by ESG-focused funds and individuals may find constraints.

Although the company has recently won a "Great Place to Work" certification for the third year in a row, the survey results may be brought into question.

*"Great Place to Work® Certification is **the easiest, most affordable** way to quantify your culture, benchmark against the world's most successful companies, and grow your business."* - from GreatPlaceToWork.com.

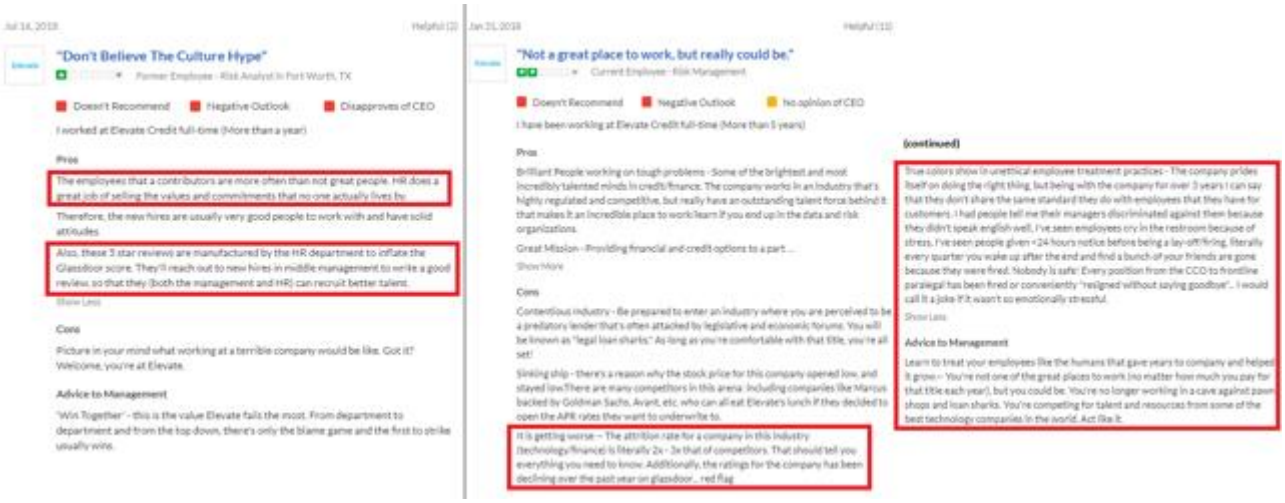
First of all, the analysis is pay-for-play (see the pricing here) and requires the company to meet a 70% certification threshold for the company's investment to pay off. Secondly, one may note that a survey that involves 78.7% of Elevate's U.S. staff may no longer be that independent and bias-free.

Finally, the survey results distribution creates an impression that the available answers are leaning towards a more optimistic response. Whereas the featured statement claiming that *"85 percent of employees say their workplace is great"* is quality-based (great, average, poor, etc.) the displayed answers are aimed at answering questions about frequency (sometimes, often, almost always, etc.).

Source: GreatPlaceToWork.com website, edited by the author. In the summarizing diagram, the agency sums up "often or almost always" with "sometimes" responses, resulting in good-looking figures above 90%. On a standard Likert scale focusing on frequency (e.g. always, very often, sometimes, rarely and never) used in academic

surveys, each value is assigned a number from 1 to 5. "Sometimes" is thus meant to have a neutral stance (3) and contrast the more positive responses (4-5). Per the standard Likert scale analysis practices (see here and here), it makes little sense to sum up the response distributions unless it's done to provide an interval.

While the above commentary may be easily criticized due to the lack of detail (and actual data), my concerns regarding the actual employee opinions are partially confirmed by employer reviews on Glassdoor.com, where it's currently rated 3.7 out of 5 stars despite the claims that the reviews may have been influenced by the HR department.



Source: Elevate reviews on Glassdoor.com.

18. Changing, competition-supportive regulatory landscape may act as a headwind for the company in the future. FDIC has an authority to significantly complicate Elevate's relationship with Republic Bank as it did with ThinkCash and First Bank of Delaware. As a data-driven lender, the company is likely to face increasing scrutiny in the future.

"If there is one way to summarize the strategic changes occurring at the Bureau, it is this: we have committed to fulfill the Bureau's statutory responsibilities, but go no further." - Mick Mulvaney, Acting Director, CFPB in the bureau's strategic plan for FY 2018-2022.

When it comes to analyzing Elevate, there are currently 4 key regulatory themes to keep an eye on:

- Leadership transition at the Consumer Financial Protection Bureau ("CFPB");
- H.R. 3299 (Protecting Consumers' Access to Credit Act of 2017);
- H.R. 4439 (Modernizing Credit Opportunities Act of 2017);
- Rising number of consumer complaints addressing UK payday lenders.

Regulatory environment Elevate operates in has witnessed numerous changes over the last several years. After issuing the long-expected payday lending rule (aka "the small-dollar rule") under its former head Richard Cordray in October 2017, the CFPB changed its course once its leadership has been overtaken by President Trump's interim appointee Mick Mulvaney. As a person who once reportedly called the agency a *"sick sad joke,"* Mulvaney is among the Republicans with an opinion that the agency is too powerful, aggressive and not business-supportive. As a result, CPFB has put the payday lending rule on hold and dropped a number of pending lawsuits against various payday lending companies (including those that contributed to Mulvaney's campaign). Per the watchdog group Public Citizen, 19 out of the 30 companies with the highest number of CFPB complaints have contributed to Mulvaney, and this year's annual payday lending industry convention happened at Trump National Doral Golf Club.

It might be too early to celebrate CFPB's new vision, however. It's important to note that the agency was established too late to have a role against the rent-a-bank scheme employed by ThinkCash and First Bank of Delaware. The scheme has in fact been ended by the FDIC, after it initiated an enforcement action against the bank in 2008. As it's been discussed before, FDIC has already ordered Republic Bank to stop its payday lending operations once. ***Should the history repeat itself, Republic's FDIC member status may play against Elastic in the future.*** The agency is already receiving requests to look into Republic Bank's operation with Elevate (see here and here). Meanwhile, as the company notes it's in its 10-K, ***the FDIC and the US Department of Justice also have a history of using their influence to restrict Automated Clearing House system access***

for lenders deemed to operating illegally. Without automated ACH money withdrawals from clients' accounts, Elevate's business would be seriously complicated.

While the current regulatory regime is doubtlessly more supportive of payday lenders, multiple lenders CFPB was expected to come after for are now given a green light to continue competing with Elevate. In fact, the change in agency's rhetoric has been an obstacle to Elevate's IPO. Here's an excerpt from a CNBC article pre-dating the IPO by 10 days: *"Elevate, which was founded under a different name in 2001, has been operating under the assumption that Obama-era regulations were here to stay. That meant complying with rules the CFPB proposed in June to end "payday debt traps" by forcing institutions to take steps to ensure borrowers had the ability to repay their loans.*

"We support the CFPB's proposed new regulations for nonprime credit and other efforts by the CFPB and many consumer groups to eliminate harmful practices and stop bad actors," Elevate said in its filing."

Currently, the CFPB is expected to issue its proposed rulemaking on the payday lending rule in February 2019. Some, however, believe that the agency needs to hurry up on its commitments before the rule comes into play in August 2019. Per the latest 10-Q filings, Elevate continues to cooperate with the agency in relation to its Think Finance case.

In the meantime, another regulatory risk may come from Elevate's data-driven lending. While the existing regulation has clearly failed to adapt to the advancements in technology, ***it's becoming increasingly acknowledged that the inexplainable processes inherent to black box lending may be exploitable.*** The key concern is that an algorithm could bypass fair-lending laws (incl. the federal Equal Credit Opportunity Act) by incorporating thousands of highly specified variables as to intentionally achieve discriminative results (further explained by American Banker here).

19. Elevate's stock price may already incorporate the passing of two Congressional bills that would be supportive of its business. Voiced opposition of the bills and a rising regulatory pressure in the UK add to the uncertainty.

It is clear why the company supports the two congressional bills that are supportive of rent-a-bank schemes. Judging from Elevate's business, one may conclude that the reason Elevate CEO Ken Rees voices his support of H.R. 4439 and 3299 bills lies not only in an intent to foster financial innovation, but also because:

- …The banks would assume the role of the primary lender in rent-a-bank (or rent-a-charter) arrangements. As explained by CSBS, an organization of state regulators, the bill *"could result in "rent-a-charter" arrangements between banks and non-bank lenders that have been specifically designed to circumvent state usury and licensing laws. For example, some states have bans on payday loans or restrictions on interest rates and loan terms.2 H.R. 4439 would open the door for lenders seeking to exploit federal preemption by partnering with a bank to offer usurious loans that would otherwise violate state law."* While the true lender classification is crucial to Elevate's operations from a legal perspective, opinions and analyses applied in different courts continue to differ, as explained in the 10-K (p. 58).
- … Issued loans would have a valid-when-made principle apply to them, which would ensure that a loan can no longer be classified as usurious if it's been classified as valid at origination. As clarified by the Congressional Budget Office, the bill *"would overturn a decision of the Second Circuit Court of appeals and permit nonbank financial institutions to charge interest rates that exceed certain state caps if a bank makes a valid loan and then sells or transfers the loan to a nonbank."*

It is unclear whether Elevate's stock price incorporates the passing of the bills or not, especially given the recent regulatory uncertainty. ***There already exists* a bi-partisan effort of attorney general persuading the Congress not to support the two bills.** Should the bills get passed, the stock will likely see a short-term bump, however. While a catalyst for Elastic and any other future bank partnerships, ***this wouldn't eliminate the financing problem as, given their risk-weighted capital ratio requirements, most banks would probably expect the lending money to come from Elevate.*** In the meantime, one should also point out the new small-dollar lending restrictions in Ohio, even though the company expects the effect to be minimal.

Meanwhile overseas, rising number of consumer complaints in the UK payday lending industry has already driven Wonga, one of the country's most popular short-term lenders with high APRs, into administration. As UK

lenders' profitability has fallen since the politically-motivated introduction of interest rate caps, managing complaints is an expensive business. As Reuters reportsin an article discussing another troubled payday lender, *"The FOS charges financial services firms 550 pounds every time it investigates a case."*According to The Independent, almost 70% of cases against payday lenders were being upheld in consumers' favour in the latest complaints data release. Although Sunny only accounted for 7.6% of Elevate's combined loans receivable at the end of 2017, the country developments should be paid attention to. Noting that the company is managing quite well, Scott Greever, managing director at Elevate Credit International, has recently told FT that Elevate is better off due to lower APRs and a lack of additional fees.

Medium Term Catalysts for Downside

As a quick recap, this short thesis was developed on the following factors:

- **ELVT is currently valued as a high-growth technology company. Given its loan book risks and true business fundamentals, one may expect a significant revaluation.** Inclusive of the company's technology, a risk-based comparative valuation implies a Price/Book multiple of 1-1.5 or lower.
- **Despite maintaining a public image of a responsible lender, the company's loan products may employ numerous regulatory loopholes and could be classified as predatory, raising the risk of future consumer lawsuits.** Elevate remains strongly reliant on automatic ACH withdrawals and pre-screened mail offers, both of which could be targeted by the regulators.
- **Any regulatory action against Elastic may complicate Elevate's rent-a-bank arrangement with Republic Bank.** With its stock near an all-time high, the bank does not mention the product in its SEC filings and, if pressured, may be tempted to forget about the business.
- In presenting itself as a counter-cyclical investment opportunity, the company succeeds at careful wording, somewhat questionable data presentation and comparisons that may be deemed indirect. With charge-off rates at the bottom of historical ranges, **the market may be misrepresenting Elevate's ability to withstand an increasingly expected economic slowdown, especially given the loan quality-linked covenants.**
- Elevate CEO's close relationship with VPC may be convincing enough to conclude that the funding's secured. The market shouldn't forget that the company has pledged all of its assets to secure the credit facilities with the investment firm, however. **Due to low free cash flow, Elevate's growth prospects remain a function of its relationship with VPC.** Before disregarding the possibility of Victory pulling the plug, investors should recognize the fact that it finances a wide range of competing online payday lending companies, including LendUp, Applied Data Finance and a recent IPO Curo Group.
- **In addition to a Debt/Equity above 5, current operating structure positions Elevate investors for a bet on the bottom tranche of its subprime loan portfolio.** Significant VC firm holdings highlight the risk of future institutional selling pressure.
- **The history may repeat itself for the Elevate CEO.** While the SEC filings note that the CFPB's case against its former parent company may still have future implications for Elevate, it may be worth highlighting that Ken Rees - who is integral to the link with VPC - is named as defendant in numerous lawsuits targeting Think Finance and VPC.
- **Company's key business - online lending for the underbanked consumer - is exposed to rising competitive forces.** UK regulatory trends and increased attention towards fair-lending law compliance among data-driven lenders add to the pressure.
- **While the LLR seasonality and upbeat guidance may serve as a temporary sentiment boost, small market capitalization makes the stock particularly vulnerable to selling pressure.**

Key Risks to the Short Thesis

- **Acquisition risk:** although likely, company's Price/Book valuation of 3.2 and anti-takeover provisions (see p.63 in the 10-K) decrease the possibility of a takeover. Given the CEO's long and challenging history with the business, it appears unlikely that Rees would be easily tempted to lose the amount of control he currently has as a CEO and Chairman with a 7% beneficial ownership (per the latest 14A filing).
- **New product success risk:** as discussed in the Q2 earnings call, the "Today" credit card is not expected to post a significant revenue impact until 2H 2019. While the company prefers not to disclose its financing for now, the product also risks driving Elevate's total effective APRs lower should the credit card offer a more affordable rate than Rise, Elastic and Sunny.

- **Regulatory risk:** the stock will most probably have a good reaction should the H.R. 4439 and 3299 bills be passed, in part due to a decrease in Elastic's operational risk. It doesn't necessarily mean that many new bank partnerships would follow, however, as the bills wouldn't eliminate the need for additional financing.
- **Credit quality improvement risk:** Brian Biglin, a former PayPal and loanDepot executive, has recently been appointed as a Chief Credit Officer and may help Elevate improve its loan book quality. Nevertheless, the company hasn't changed its stance on maintaining the charge-off rates at historical ranges yet.
- **Credit facility increase risk:** while a further increase in VPC's credit facilities appears likely due to the credit card introduction, an above-expectations increase in financing may reprice the stock substantially higher on growth expectations. While possible, one should note that the company continues to search for different funding sources and may look to refinance its debt before additional Fed rate hikes.
- **Market and comparative valuation risk:** the stock appears to be short-term oversold on a technical basis (see here). Should the market - or lending companies in particular - experience significant near-term upside, ELVT may appear less overvalued from a comparative valuation standpoint. Investors considering exposure should note that ELVT is a fairly illiquid name for a $370mn market cap.

Conclusion

Trends, equity valuations and investor sentiment have a volatile nature. What didn't matter to ELVT's valuation only recently may play a crucial role once the market reassesses its view on future developments.

Based on an expected revaluation to a Price/Book multiple of 1-1.5, **I assign ELVT a "Sell" rating with a 12-18 month price target of $2.57-3.86**, implying a 55-70% downside to the current stock price of $8.59. As of this writing, there are approximately 1 million shortable shares available to borrow at 0.91% on Interactive Brokers.

I actively trade ELVT with an intention to ride the stock lower in accordance with my medium-term price expectation. Given the stock's taste for sharp upside moves and equally strong reversals, I will mostly stick to a trend-following approach on correctional moves and will seek the first opportunity to cut my losses on any stronger upside reversal.

Source: made via TradingView.

APPENDICES

Appendix 1. Detailed overview of the events preceding the Think Finance bankruptcy.

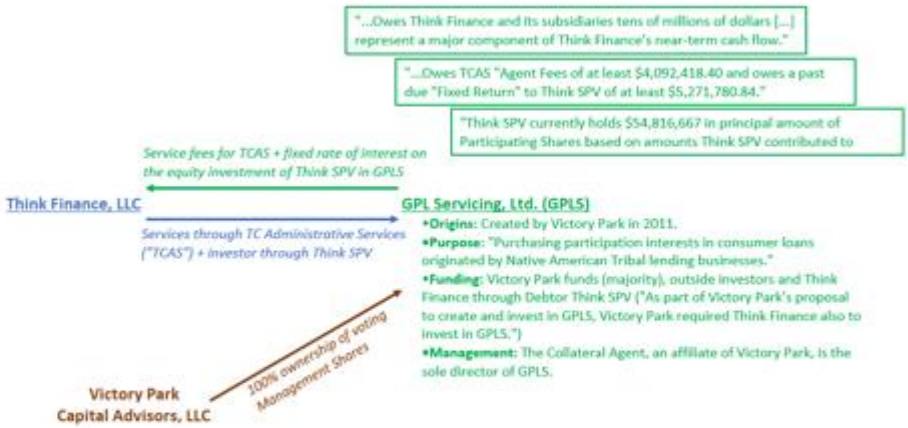
Diagrams below summarize the tribal lending business of Think Finance, LLC, GPL Servicing, Ltd. ("GPLS") and Victory Park Capital Advisors, LLC as described in the bankruptcy filing. In 2011, Victory Park creates GPL Servicing, Ltd. - a special purpose vehicle with no employees intended to be used for "purchasing participation interests in consumer loans originated by Native American Tribal lending businesses," represented by Plain Green, LLC, which is wholly owned by the Chippewa Cree Tribe of the Rocky Boy's Indian Reservation.

The majority of the company's financing comes from several Victory Park funds. With some financing from certain outside investors, Victory Park requires Think Finance to also have a stake, which it does through Think SPV.

Source: made by the author using TFI's bankruptcy filing.

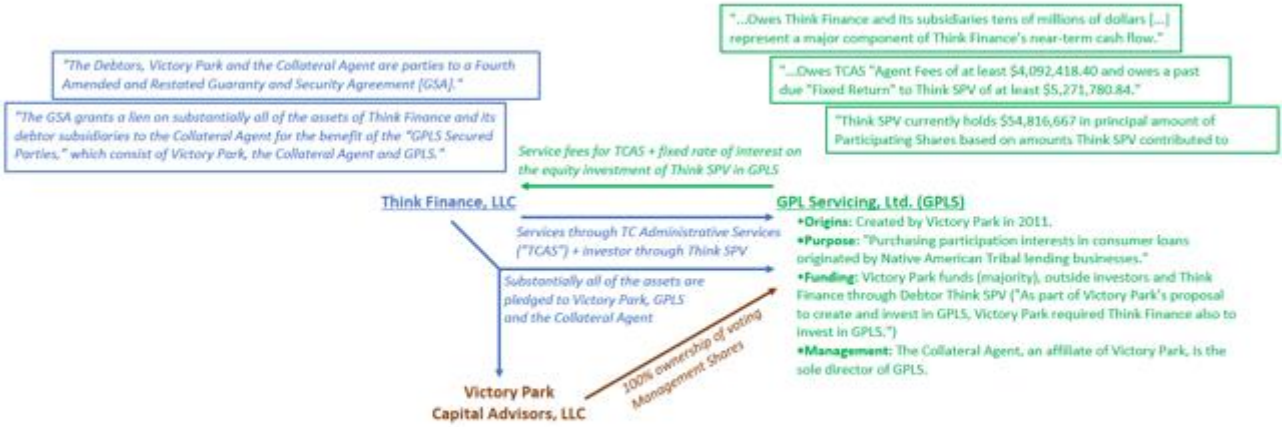
In order to optimize the legal responsibility, the scheme is structured as to position Think Finance as a service provider rather than a lender.From the bankruptcy filing: "Neither GPLS, TCAS, nor any of the other Debtors originate or participate in the collection of the underlying consumer loans made by the Native American Tribal lenders." Nevertheless, a Chippewa Cree tribe member and a former Plain Green employee, informed Huffington Postthat the tribal lender had no particular influence on the lending. At the end of each day, a Plain Green officer's signature would approve each of the loans accepted by Think Finance's software.

Judging from the description of Think Finance's dependency on its equity interest in GPLS, one may conclude that tribal lending operations constituted a substantial portion of its operations at that point.



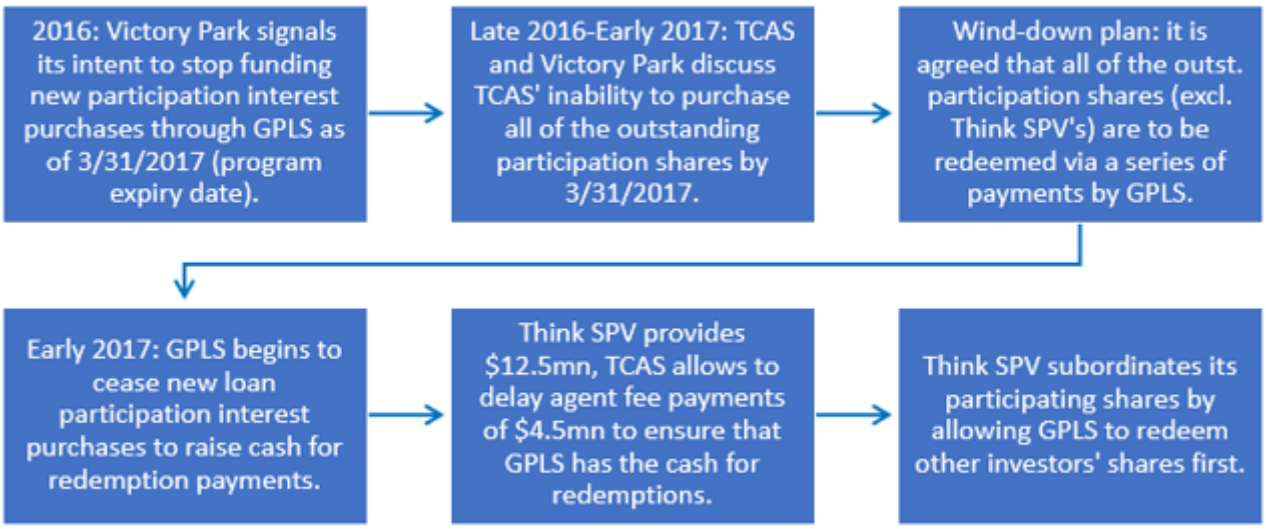
Source: made by the author using TFI's bankruptcy filing.

To follow up on the previous point, it is notable that the majority of Think Finance's assets is pledged to Victory Park, the Collateral Agent (an affiliate of VPC) and GPLS on the basis of a certain guaranty and security agreement.



Source: made by the author using TFI's bankruptcy filing.

Later on, its financial dependency on Victory Park is only reinforced. Think SPV effectively subordinates its participating shares as VPC's funds and other investors begin to withdraw their money.



Source: made by the author using TFI's bankruptcy filing.

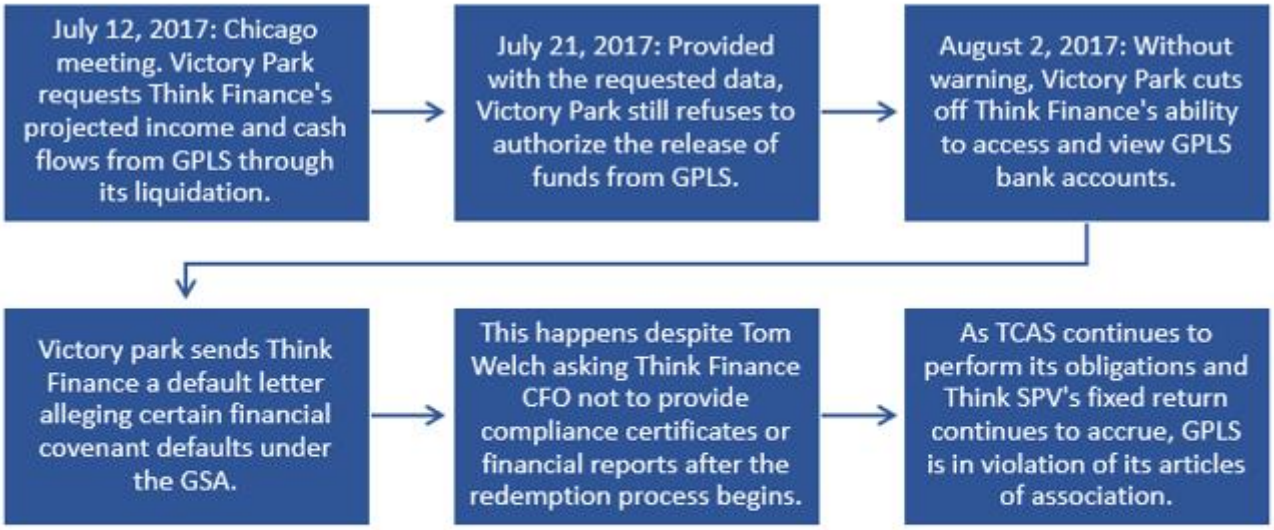
Once Victory Park and other investors are done redeeming their shares, TCAS is only able to withdraw a portion of the outstanding agent fee before VPC swiftly revokes Think Finance's authority to wire money out of GPLS. ***During a phone call with Victory Park, Barney C. Briggs, Think Finance CEO, is told by Tom Welch, a vice-president with Victory Park, that he needs to consult with Richard Levy, VPC CEO and founder.***

One should probably note that Barney Briggs, Think Finance CFO, has joinedthe company just 8 months before it filed for bankruptcy.

Barney C. Briggs, Think Finance CFO:
"I was surprised by the denial of the request for payment of the $2 million because GPLS held more than twice that amount in its accounts. Mr. Welch had previously indicated that following redemption he would comfortable with wiring funds from GPLS to the Debtors to satisfy past-due obligations as frequently as weekly [...] During out telephone conversation on June 28, 2017, however, Mr. Welch indicated that he needed to consult with his superior, Richard Levy, before authorizing any additional payments to Debtors TCAS or Think SPV, and would respond to the Debtors' request for payment by Friday, June 30, 2017."

Source: made by the author using TFI's bankruptcy filing.

Soon thereafter, even the ability to view GPLS bank accounts is cut off from Think Finance. It all gets a little more confusing at the moment when Victory Park decides to accuse TFI of violating financial covenants which had been previously agreed to no longer be applicable. The idea behind the agreement was driven by Think Finance's net worth declining below 0 following the $12.5mn capital injection from Think SPV to ensure that GPLS had ample liquidity for the redemption process. The company was fully compliant as of the latest required certificate.



Barney C. Briggs, Think Finance CFO:
"This surprised me because Tom Welch had agreed such financial covenants were no longer applicable and had instructed me not to provide compliance certificates or financial reports following the commencement of the redemption process in March 2017."

Source: made by the author using TFI's bankruptcy filing.

On August 7, 2017, Think Finance, TCAS and Think SPV started an arbitration proceeding against Victory Park, its affiliates, the Collateral Agent and GPLS. On September 1, 2017, it became known that GPLS wired $10mn on August 2 and another $5.5mn on August 21, 2017 to an account of Victory Park Management, LLC, leaving insufficient funds to make TCAS and Think SPV whole.

During the arbitration, Victory Park stated that it had *"exercised its rights as a first priority secured party to control the cash collateral"* and that it *"had the absolute right to take control of the collateral for its own protection."*

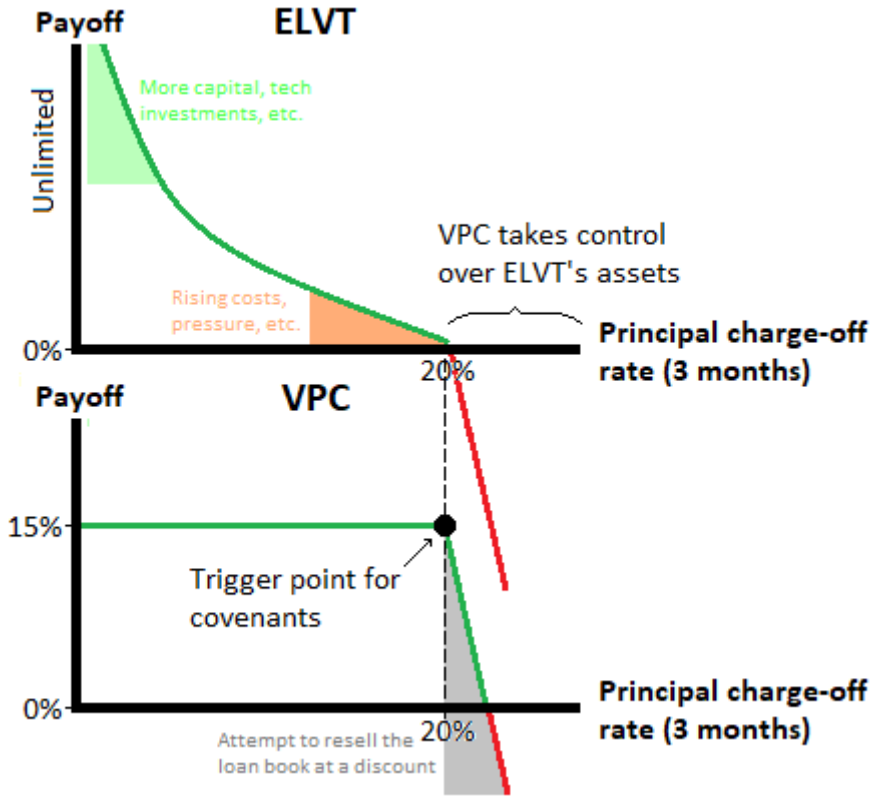
Nevertheless, there was an attempt to negotiate a consensual resolution for Think Finance to be able to meet its short-term liquidity needs, and on September 12, 2017, just before the arbitration hearing, a Confidential Interim Settlement Agreement ("ISA") was created. Although Think Finance received a payment of $4.3mn on the same day, provided in accordance with ISA, the next payment of $4.2mn was not received on the set date of October 2, 2017. Even though the agreement only postponed the arbitration and was not covering the full obligations towards Think Finance, the company did not receive other payments under ISA as of the bankruptcy filing date. This, however, did not prevent Victory Park from making 2 additional $5mn payments from GPLS to an account of Victory Park Management, LLC. Per the filing, "Victory Park did not have the permission of the Debtors to make that payment unless it complied with the ISA, which it did not."

An even more detailed overview of the tribal operation is available in Gingras et al v. Victory Park Capital Advisors, LLC et al.

Appendix 2. An approximate illustration of VPC and ELVT payoff structure depending on the principal charge-off rates.

Assuming limited fluctuations in the USD Libor, VPC's payoff structure is more or less fixed at around 15% in normal conditions. Equity, in the meantime, always has a positive relationship with loan quality. It is at this point that investors should be reminded of Elevate's lack of commitment to drive the charge-off rates significantly lower, which would likely result in accelerated shareholder returns (higher FCF, new products, technology investments, etc.). Instead, the shareholders may face the risk of above-average principal charge-off rates, which would likely result in additional pressure on the bottom line. Should the 3-month principal charge-off rate reach 20%, equity holders may face significant difficulties on recovering their investment as VPC would be able to accelerate the debt

and take control over ELVT's assets. Since the exhibit only serves as an approximate illustration, one should note that Elevate may also become significantly unprofitable at even lower principal charge-off rates, and vice versa.



Made by the author using the data from company's filings. Only serves as an approximate illustration. Assumes that ELVT's cost of debt is fixed at approximately 15%. Curve shapes are approximated based on the listed assumptions and may significantly differ from the actual ones.

Appendix 3. A proponent of brighter financial future or just a profiteer? The possible disconnect between ELVT's public image and the actual terms it provides to its customers may add to the future lawsuit risk.

Despite successful marketing and PR, various aspects of Elevate's loan brands resemble payday loan features. Although the company's products are not meant to be a long-term credit solution, according to CEO, repayment terms average 12-14 months.

Starting with inspiring mission statements and ending with investor presentations that seemingly always feature photos with small children, the company does a great job on the public relations front. No matter how you put it, however, charging your customers APRs exceeding 200% doesn't sound like a commitment to put the customer out of a debt cycle. Per the 10-K filing, maximum APRs for Rise charges reach 290-299% in at least 11 states.

General selling points like lower rates, credit reporting, speed, ease of access and financial education are already becoming a standard for online payday lenders (e.g. see LendUp and OppLoans). They don't make Rise special enough to justify its maximum rates, however. From a Fortune article on Elevate: *"These rationalizations fail, however, to impress Diane Standaert, who studies the payday loan industry at the non-profit Center for Responsible Lending in Washington. She* ***claims that Rise is no better than other payday lending products, and that Elevate's business model relies on creating a "debt trap" where customers are forced to take exorbitant new loans in order to manage existing ones."***

Elastic, operating structure of which may be a risk in itself, is another story. Despite the stated effective APRs of 97% in Q2 2018, determining the actual APRs faced by the consumer involves a rather ambiguous calculation since the line of credit is meant to be continuously drawn upon and thus doesn't have a hard repayment term. Are the consumers actually escaping the so-called debt cycle with Elastic? Not exactly so, according to reviews available on the Internet. Here's an excerpt from a BrightRates.com review: *"…Perhaps this is the biggest downside to Elastic and any line of credit product: it makes borrowing very easy. That's great if you just need some cash to hold you over until next month - it's cheaper than payday and alternatives.* ***But the average Elastic borrower pays the***

minimum which means the loan is not paid for 10 months. At that point, the borrower has paid enough in fees to make Elastic about as costly as taking out a payday loan."

It's certainly important to note the difference between the monetary sums involved in a typical payday loan and those offered by Elevate. Whereas standard payday loan options are commonly capped at $500 or even less (e.g. the Google (NASDAQ:GOOG) (NASDAQ:GOOGL)-backed LendUp with $250), the figure is only a starting point for Elevate's U.S. loans and is way below their average loan balances. Even though an APR comparison makes a lot of sense, a common payday loan user is likely to think in dollar- rather than APR-based terms. For a typical borrower, repaying a $44 finance charge on a 21-day $250 loan from LendUp wouldn't probably be as challenging as repaying $558.27 in fees on a $800 Rise loan for 5 months (actual terms for a common Rise loan in Texas). Despite the similarity in APRs (305.9% and 299%), a consumer repaying a Rise loan via the minimum required payments faces much more interest repayment than a typical payday loan borrower does. This not only makes the two non-comparable and complicates repayment, but also doesn't sound as consumer-friendly as the company portrays itself to be. The APRs aren't that much cheaper if a quicker repayment plan is considered, too:

2 weeks, bi-weekly payments

t	CFs (borrower)		IRR	APR
0	$	800.00		
1	$	(861.01)	8%	198%

1 month, bi-weekly payments

t	CFs (borrower)		IRR	APR
0	$	800.00		
1	$	(460.76)	10%	259%
2	$	(460.75)		

2 months, bi-weekly payments

t	CFs (borrower)		IRR	APR
0	$	800.00		
1	$	(260.24)	11%	297%
2	$	(260.24)		
3	$	(260.24)		
4	$	(260.26)		

3 months, bi-weekly payments

t	CFs (borrower)		IRR	APR
0	$	800.00		
1	$	(193.06)	12%	305%
2	$	(193.06)		
3	$	(193.06)		
4	$	(193.06)		
5	$	(193.06)		
6	$	(193.08)		

5 months, bi-weekly payments

t	CFs (borrower)		IRR	APR
0	$	800.00		
1	$	(138.69)	11%	299%
2	$	(138.69)		
3	$	(138.69)		
4	$	(138.69)		
5	$	(138.69)		
6	$	(138.69)		
7	$	(138.69)		
8	$	(138.69)		
9	$	(138.69)		
10	$	(138.73)		

Made by the author using the disclosure sheet for the above-mentioned $800 Rise loan in Texas.

In the meantime, even though that Elevate's brands provide a warning against their use as a long-term credit solution, average repayment term spans around 12-14 months (according to a Dec 2017 LendAcademy podcast with Rees). Since the figures significantly exceed the suggested repayment terms available on the websites of Elastic and Rise, one may conclude that the actual costs to the consumer could be much closer to those of a payday loan.

Appendix 4. Elastic's positioning may create a false impression that the consumer is better off paying down the loan slightly faster.

As seen in the tables below, by applying an additional payment to the required minimum, the borrower does not witness a significant favorable improvement in terms of APRs.

Let's consider an example of a $4,500 loan with a bi-weekly payment schedule, sourced from Elastic's website. As you can see, the IRR-calculated APR for this loan is approximately 104%.

Week	Balance	CA fee	CB fee	Principal payment	Required payment	Cash flows, borrower	IRR	APR
0	$4,500.00	$225.00	$ -	-	$ 225.00	$ 4,275.00	4.00%	103.99%
2	$4,275.00	-	$ 175.00	$ 225.00	$ 400.00	$ (400.00)		
4	$4,050.00	-	$ 165.00	$ 225.00	$ 390.00	$ (390.00)		
6	$3,825.00	-	$ 155.00	$ 225.00	$ 380.00	$ (380.00)		
8	$3,600.00	-	$ 145.00	$ 225.00	$ 370.00	$ (370.00)		
10	$3,375.00	-	$ 135.00	$ 225.00	$ 360.00	$ (360.00)		
12	$3,150.00	-	$ 125.00	$ 225.00	$ 350.00	$ (350.00)		
14	$2,925.00	-	$ 115.00	$ 225.00	$ 340.00	$ (340.00)		
16	$2,700.00	-	$ 105.00	$ 225.00	$ 330.00	$ (330.00)		
18	$2,475.00	-	$ 95.00	$ 225.00	$ 320.00	$ (320.00)		
20	$2,250.00	-	$ 85.00	$ 225.00	$ 310.00	$ (310.00)		
22	$2,025.00	-	$ 85.00	$ 225.00	$ 310.00	$ (310.00)		
24	$1,800.00	-	$ 75.00	$ 225.00	$ 300.00	$ (300.00)		
26	$1,575.00	-	$ 65.00	$ 225.00	$ 290.00	$ (290.00)		
28	$1,350.00		$ 55.00	$ 225.00	$ 280.00	$ (280.00)		
30	$1,125.00		$ 45.00	$ 225.00	$ 270.00	$ (270.00)		
32	$ 900.00		$ 35.00	$ 225.00	$ 260.00	$ (260.00)		
34	$ 675.00		$ 25.00	$ 225.00	$ 250.00	$ (250.00)		
36	$ 450.00		$ 15.00	$ 225.00	$ 240.00	$ (240.00)		
38	$ 225.00		$ 5.00	$ 225.00	$ 230.00	$ (230.00)		
266 days	**$4,500.00**	**$225.00**	**$1,705.00**	**$ 2,925.00**	**$ 6,205.00**	**$ (175.00)**		

CA fee – cash advancement fee.
CB fee – carried balance fee (similar to interest).

Source: made by the author using the data from Elastic's website.

Just as advertised, by applying an additional payment of $100, the consumer saves $550 and repays the loan 32% faster. Due to the loan structure, however, its 104% APR remains as expensive as it's been without additional repayment. ***While Elastic benefits from faster repayment due to compound interest, its profitability might face a headwind should the customers choose to avoid it.*** While it may still be argued that the customer is way better off if the loan is immediately repaid in a lump sum (which can be done with no additional fees), costs of a typical Elastic loan may imply that this may not be an option for most of the customers.

"By paying an additional $100.00 on each remaining payment, you could save up to $550.00."

Week	Balance	CA fee	CB fee	Principal payment	Required payment	Additional payment	Cash flows, borrower	IRR	APR
0	$4,500.00	$225.00	-	-	$ 225.00	$ 100.00	$ 4,175.00	3.99%	103.82%
2	$4,175.00	-	$ 165.00	$ 325.00	$ 390.00	$ 100.00	$ (490.00)		
4	$3,850.00	-	$ 155.00	$ 325.00	$ 380.00	$ 100.00	$ (480.00)		
6	$3,525.00	-	$ 145.00	$ 325.00	$ 370.00	$ 100.00	$ (470.00)		
8	$3,200.00	-	$ 125.00	$ 325.00	$ 350.00	$ 100.00	$ (450.00)		
10	$2,875.00	-	$ 115.00	$ 325.00	$ 340.00	$ 100.00	$ (440.00)		
12	$2,550.00	-	$ 105.00	$ 325.00	$ 330.00	$ 100.00	$ (430.00)		
14	$2,225.00	-	$ 85.00	$ 325.00	$ 310.00	$ 100.00	$ (410.00)		
16	$1,900.00	-	$ 75.00	$ 325.00	$ 300.00	$ 100.00	$ (400.00)		
18	$1,575.00	-	$ 65.00	$ 325.00	$ 290.00	$ 100.00	$ (390.00)		
20	$1,250.00	-	$ 45.00	$ 325.00	$ 270.00	$ 100.00	$ (370.00)		
22	$ 925.00	-	$ 35.00	$ 325.00	$ 260.00	$ 100.00	$ (360.00)		
24	$ 600.00	-	$ 25.00	$ 325.00	$ 250.00	$ 100.00	$ (350.00)		
26	$ 325.00	-	$ 15.00	$ 275.00	$ 240.00	$ 50.00	$ (290.00)		
182 days	**$4,500.00**	**$225.00**	**$1,155.00**	**$ 4,175.00**	**$ 4,305.00**	**$ 1,350.00**	**$ (1,155.00)**		

Source: made by the author using the data from Elastic's website.

Disclosure: I am/we are short ELVT.

I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

Additional disclosure: This article is published for discussion purposes only and is not intended to be used as the primary basis of investment decisions. I am not an investment advisor. The article is based on data obtained from

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Ticker	Company Name	Market Cap	PE Ratio	Div Yield	1M Perf
ELVT	**Elevate Credit**	**$183.99M**	**-**	**0.00%**	**-47.15%**
CURO	CURO Group Holdings Corp.	$644M	-	0.00%	-53.46%
ENVA	Enova International, Inc.	$810.6M	12.07	0.00%	-17.88%
NSSC	NAPCO Security Technologies, Inc.	$263.56M	33.5	0.00%	-5.89%
SSTI	ShotSpotter	$416.66M	-	0.00%	-36.89%
VIRT	Virtu Financial, Inc.	$2.54B	10.73	4.05%	15.99%
OFLX	Omega Flex, Inc.	$610.55M	33.06	4.76%	-14.98%
BSCL	Invesco BulletShares 2021 Corporate Bond ETF	$1.06B	-	1.35%	-0.29%

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The stock appears to be reacting to the latest news from California.

Los Angeles Times: "The state's top financial regulator launched an investigation Wednesday of high-cost consumer lenders after the failure of several bills in the Legislature that would have tightened oversight of the industry.

The Department of Business Oversight sent letters to 20 high-interest lenders, asking about their use of so-called lead generators — companies that operate websites connecting consumers to their firms.

The department's questions include how many customers come through lead generators, how loans to those customers are underwritten and how many of those customers wanted to borrow less than $2,500. Under state law, lenders can charge dramatically higher rates on loans of $2,500 or more than for smaller loans.

[...]

"What we're seeking is additional information that will help us ensure lenders and lead generators do not use unfair, deceptive practices to trap consumers in high-cost loans they don't want and can't afford," said Owen, who announced the inquiry.

The department targeted companies that last year made at least 1,000 consumer loans of $2,500 to $9,999, and that charged interest rates of 100% or higher on at least 90% of those loans.

The list includes several prominent online-only lenders — Elevate, Enova and related companies CashCall and LoanMe — as well as companies with bricks-and-mortar locations such as TitleMax, Ace Cash Express and MoneyMart.

Together, the 20 companies accounted for more than 60% of all triple-digit APR loans in that size range made in California last year, the department said.

Owen also suggested that the inquiry marks the beginning of a possible crackdown amid inaction by the Legislature."

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RickinMiami

Comments303 | + Follow

Wow you put the smack down on ELVT! Skeletons out of the closet. Very well done.

On their site they say they charge up to 199% interest. I thought that only happend in the 3rd world. I don't think anyone can be elevated...paying those levels of interest.

www.elevate.com/...

04 Oct 2018, 10:20 AMReply0Like

Anton Tyumin, Contributor
Comments207 | + Follow
Author's reply »

Thanks for commenting, Rick.
Despite the high rates, Elevate's APRs actually fall short of those offered by many of its online and in-store competitors, which can exceed 700% for short-term loans.
While the non-prime risk clearly warrants a higher rate, one may argue that excessive rates also have a role in making non-prime borrowers default (and thus making them even more risky to lend to - a vicious cycle).
04 Oct 2018, 11:00 AMReply0Like

aaaaaaaaaaaaaaaa2
Comments6 | + Follow
Bull Case.
valueinvestorsclub.com/...
04 Oct 2018, 10:29 AMReply0Like

Anton Tyumin, Contributor
Comments207 | + Follow
Author's reply »

...Which disregards competition, regulatory and loan quality risks, as well as states that the link with TFI is limited at best (which isn't true): "Don't freak out over the ThinkFinance bankruptcy as I did – there is no connection to Elevate, just saving you some potential stress." An example of how not to perform your due diligence, in my view.
04 Oct 2018, 10:46 AMReply1Like

Nat Stewart, Contributor
Comments1160 | + Follow
It will be interesting to see what interest rates the company can get when they complete their refinancing in Q1 2019, and also how price will act going into earnings after this massive dip in price.
04 Oct 2018, 11:01 AMReply2Like

Anton Tyumin, Contributor
Comments207 | + Follow
Author's reply »

Agree. In 2017, a larger competitor with lower loan loss provisions (34% of revenue in 2017) got a 12% rate for $605mn in Senior Secured Notes maturing in 2022. Judging from ELVT's risk and assuming that the Fed stays on course, I would expect a rate of 14+.
04 Oct 2018, 11:16 AMReply0Like

Nat Stewart, Contributor
Comments1160 | + Follow
I think the interest rate is going to go down significantly, but we shall see.
04 Oct 2018, 11:23 AMReply1Like

Billy Duberstein, Marketplace Contributor
Comments220 | + Follow
Author clearly misses:
1. Late last year the company saw an opportunity for growth and accelerated loan issuance, which explains the seasonality Q4-Q2 factor cited in the article. The author seems to think a business should have the exact same results every year, which is totally off-base for a small growing company adapting to a dynamic environment.
2. A 1-1.5 book value? Are you serious? This is not a mature large-cap bank. the company is growing revenue 23% last quarter and since it is just getting to profitability the operating leverage will be big, causing EPS to grow significantly. The stock is trading at 6x forward earnings.
3. If there are so many regulatory risks with this "terrible" business, why on earth would a large-cap bank serving Prime customers want to move into this space and compete? You think Wells Fargo, with all of their headline problems, are going to come into this space?

In addition, fintech is a scale business, so Elevate being the largest in the sub-prime segment comes with certain competitive advantages. Seems like a nice position in this niche.
4. Since the company is now profitable, it will start self-funding and/or paying down the credit facilities going forward. The fact that it was able to lower its interest rate seems to indicate it is safer than you purport in the article. Otherwise, these refinancings wouldn't have happened.
The only salient points here are the regulatory risks, but that is a very uncertain picture. The company clearly offers a better product at lower rates than traditional brick and mortar Payday companies. At 6x forward earnings and a 20%+ growth rate, I'd say these risks are probably priced in. I'll admit this is a big uncertainty -- however, it's unlikely the company would be thrown out of every state they operate in as the state regulators would have to hit the company one by one.
04 Oct 2018, 03:31 PMReply1Like

aaaaaaaaaaaaaaaa2
Comments6 | + Follow
I'll also like to add there's so many bad payday loan companies out there that should get hit first before ELVT.
04 Oct 2018, 03:49 PMReply1Like

Billy Duberstein, Marketplace Contributor
Comments220 | + Follow
Very true. A much "less bad" solution.
04 Oct 2018, 04:10 PMReply0Like

Anton Tyumin, Contributor
Comments207 | + Follow
Author's reply »

Hello Billy,
1. "Opportunity for growth and accelerated loan issuance" doesn't change the fact that LLR seasonality is tied to fluctuations in past due loans.
2. I am serious. Santander Consumer (SC), known for its exposure to subprime auto loans, hasn't traded at a P/B significantly above 1 since 2015. Enova International (ENVA), P/B multiple of which also crashed to 1 in late 2015, has been crashing together with ELVT lately (they are competitors).
3. Please provide a source proving that ELVT is the largest player in non-prime (or subprime). Hint: it isn't.
The banks don't need to offer the loans themselves - they may be perfectly fine with funding/investing in startups that will do that for them and, as discussed in the article, that's already happening.
4. ELVT's historical (and recent) cash flows are not yet enough to fund its growth. If the company is indeed "safer," where is the 2nd Elastic funding source expected since Q1 2017?
10-Q for Q1 2017: "During the second quarter of 2017, we expect an additional SPV will be created as another funding source for the Elastic line of credit product. This additional SPV for Elastic would provide additional funding, diversified funding sources and further lower the cost of funds." Per the SEC filings, ELVT continues to "expect" it up until this day.
"It's unlikely the company would be thrown out of every state they operate in as the state regulators would have to hit the company one by one." - An FDIC decision to look into ELVT's business with Republic Bank would likely put Elevate at risk of losing about 40% of its business (Elastic's share of total ending combined loans in Q2 2018).
04 Oct 2018, 04:23 PMReply0Like

1nsight
Comments2 | + Follow
Point 2 on ENVA is not a fair comparison. 2015 is when talk of the CFPB's small dollar rule started, and this caused ENVA and other payday lenders to shift to longer tenor loans. There was massive uncertainty whether they could make this profitable and secure funding for what would need to be a considerably larger book. Also, the past couple weeks have been shitty for the space generally, as hurricane Florence hit areas that payday lenders operate in, which will cause delayed/forgiven payments and higher provisions (think CURO and hurricane Harvey in 3Q17). Couple that with ENVA also being named as one of the companies the California DBO is investigating and that explains the recent dip. The real question is what % of revenue is derived in California and is there potential fallout/precedent for other states to go after these companies should the CDBO's inquiry prove successful.
04 Oct 2018, 05:31 PMReply0Like

Anton Tyumin, Contributor
Comments207 | + Follow
Author's reply »

Hello 1nsight,

I agree with your points, but it's also worth highlighting that late 2015/early 2016 is also an example of a rapid shift towards a risk-off environment on US equities (with Russell 2000 plunging by more than 25% in a relatively short time period), which undeniably contributed to ENVA's revaluation on the small dollar rule talk. If you plot both on a chart, you will see that Russell 2000 and ENVA have mostly been moving (and sharply recovering) together throughout 2016.
04 Oct 2018, 05:54 PMReply0Like

Billy Duberstein, Marketplace Contributor
Comments220 | + Follow

Ok so you may be right that Enova's consumer loan segment is about the same size as Elevate's. Elevate is a leader, not the leader.
I also think a federal investigation under this administration into a company that is providing a better solution than payday loans is remote. Not impossible, but remote.
1. Regarding the LLR, you are basically accusing the company of fudging its loss reserves to make earnings, without much evidence. So, maybe it's true, but it just seems like conjecture. If people don't receive as many refunds in the future (also conjecture, but totally possible), I'm sure Elevate's big data models will reflect that.
2. Santander is not a good comp as it's an auto lender. Admitted that Enova is of similar scale and product but diversified across different products and geographies like Brazil.
2b. If Elevate traded at 1x book it would trade at 2x forward earnings. Are you saying this is a reasonable valuation? Though I'm assuming you are implying that its earnings are going to collapse for some reason. Remember a lot of the loan losses and marketing costs this year have resulted in accelerated growth and better credit profiles, at least so far.
3. On competition, I think your article linked to another article (it wasn't actually in your writeup). That article discusses US Bancorp just entering the near-prime space recently. It seems that US Bancorp is just testing the waters on a subprime product only to customers of US Bank checking accounts, not those who don't have access to traditional solutions (like Elevate). Two, the article cites other big bank fintech startups like Marcus, but Marcus isn't going after this subprime segment, it's going after prime customers. Same for Lightstream. I'm not seeing evidence of a ton of subprime unsecured activity from the big banks. There's Avant but that's more near-Prime, and LendUp is smaller.
4. "ELVT's historical (and recent) cash flows are not yet enough to fund its growth." Well, duh. But that was the past.The company has reached scale and is guiding for $25-$40 million in net income this year, which will probably grow 50% annually based on the current revenue growth and operating leverage. I wasn't saying it could all fund its loans now, but in a year or two it will likely have much less need for its credit facilities as principal outstanding typically is only growing ~$130 million/ year.
Also, why do you think Victory Park lowered the interest rates on the loans to Elevate recently?
05 Oct 2018, 01:03 AMReply1Like

Anton Tyumin, Contributor
Comments207 | + Follow
Author's reply »

Enova and Elevate are not the only nor the largest in the industry. Don't forget about the private payday lenders, too.
1. As discussed in the article, LLR seasonality provides reasonable evidence to expect a mean-reversion and higher loan loss provisions in 2H 2018.
2. It is a lender with similar loan loss provisions as a % of revenue - you will not find that many public companies with such low quality loans. As stated in the article, it is a risk-based comparative valuation.
2b - Expectation that a forward earnings-based valuation is reasonable implies that the underlying assumptions (and the resulting figures) are accurate. What are the assumptions behind the forward earnings estimate you are referring to?
"Remember a lot of the loan losses and marketing costs this year have resulted in accelerated growth and better credit profiles, at least so far." - Yet ELVT's charge-offs remain below the lower bound of the historical target range. Blaming the low profitability on growth is OK, but it doesn't make a difference unless the company chooses to slow down fairly soon. "In other words, we could have doubled our quarterly net income and EPS if we grew more slowly. But we like the credit quality we're seeing and the CAC is within our targeted range, so we intend to continue to acquire new customers that are faster pace while trying to balance profitability expectations." - Q2 earnings call.
3. "It seems that US Bancorp is just testing the waters on a subprime product only to customers of US Bank checking accounts, not those who don't have access to traditional solutions (like Elevate)."
Those are the same individuals. A low credit score doesn't mean that one cannot have a checking account. From my article: "According to Elevate's own data, 65% of non-prime Americans have a customer relationship with a traditional bank."
See the link here: newmiddleclass.org/...
The CEO's presentation cited in the article may also be helpful: www.youtube.com/...
4. "But that was the past" is too general. Please provide any numerical evidence showing that Elevate has "reached scale."
As discussed in the article, Elevate may overestimate its annual guidance due to LLR seasonality (higher provisions in the 2nd half of the year).
On May 9, 2017, the company guided for $13-19mn in 2017 net income. Excluding the one-off tax epense, 2017 income was $5.5 million. I'm not saying that a future miss is cast in stone, but a guidance revision in Q3 appears more than likely to me.
"Principal outstanding typically is only growing ~$130 million/ year." - this may not be comparable to $16.7mn in 2017 FCF (even if

we assume strong growth).
Victory and Rees have a long history and are able to negotiate the terms. The CFO's expectation for a future cost of funds rate of approx. 11%, however, appears to be too optimistic to me.
05 Oct 2018, 05:40 AMReply0Like

Billy Duberstein, Marketplace Contributor
Comments220 | + Follow
1. You don't think that the company is aware of the seasonality and has baked that into guidance?
2. The assumptions behind the P/E are from the company and also analysts which are anticipating $1.09 EPS (highest estimate is $1.25) in 2019 vs. $2.64 of book value.
3. The US Bank product is only for customers of that bank.
4. All you have to do is look at the company's recent slide presentation (slide 7 - seekingalpha.com/... to show fairly consistent growth in EBITDA which has just crossed into GAAP profitability. The trajectory looks pretty clear that the company should be more profitable, barring a reversal of the current trend.
The company's net income and EBTIDA have already hit the halfway mark of the CY guidance and the company will be bigger int he back half due to growth. Q4 is usually a high-profit quarter, along with Q1, while Q2-3 are the ones that are lower-profit. It's not 1H-2H as you described.
05 Oct 2018, 05:23 PMReply0Like

Anton Tyumin, Contributor
Comments207 | + Follow
Author's reply »

1. Have you seen the annotated chart in the article? I guess the company was completely aware of it in 2017, when it started with an optimistic annual net income guidance in Q1 2017 ($13-19mn), cut the guidance in Q3 2017 ($10-15mn) and then still significantly underperformed it on adjusted basis ($6mn).
2. Given what I've described above, I would not take the company's guidance at face value.
Are you comfortable with basing your share price expectations on longer-dated sell-side estimates, which have a tendency to be readjusted lower with time?
3. That's right. And every other bank with non-prime customers will be able to follow suit and have a massive competitive advantage on customer acquisition costs (and remember, 65% of non-prime customers have a checking account at a traditional bank).
4. The fact that the company has turned profitable doesn't mean that its FCF is enough for a significant debt reduction over the next couple of years, as you are implying.
"Q4 is usually a high-profit quarter, along with Q1, while Q2-3 are the ones that are lower-profit. It's not 1H-2H as you described."
Really? Let's take a look at the quarterly NI trends (in million):
2016 (Q1-Q4): $5.8 ($7.5) ($16.3) ($4.4)
2017 (Q1-Q4): $1.7 $3.0 $0.6 ($12.2)*
*Q4 2017 is ($0.3) without the tax charge.
05 Oct 2018, 06:33 PMReply0Like

Billy Duberstein, Marketplace Contributor
Comments220 | + Follow
"Q1, they tend to pay down their debt which lowers loan loss reserves and increases adjusted EBITDA. However, as our portfolio balances begin growing again we experience higher marketing costs of loan loss reserves which compress margins in Q2 and Q3, but typically result in peak revenues and earnings in Q4."
Net income may fluctuate based on how much the company chooses to reinvest and tax one-offs, but I think I'll trust management on the general seasonality here as they have to reason to lie about it.
2017 NI misses can be largely attributed to the massive Hurricanes Irma and Harvey which hit in Q3.
06 Oct 2018, 11:37 AMReply0Like

Billy Duberstein, Marketplace Contributor
Comments220 | + Follow
-- that quote was from the Q1 2018 CC, just for your reference
06 Oct 2018, 11:38 AMReply0Like

Anton Tyumin, Contributor
Comments207 | + Follow
Author's reply »

I appreciate the quote, but it doesn't change (1) the historical quarterly NI figures I've posted above and (2) the fact that the additional provision for loan losses has generally been negative in 1H and positive in 2H, putting pressure on Q3-Q4 earnings.
Agree, but note that the hurricane impact has already been incorporated in the Q3 guidance change ($10-15mn). From the earnings presentation: "Lowering fiscal year 2017 guidance due to the delay in the 2017 tax refund season and the impact of the recent hurricanes."
06 Oct 2018, 01:17 PMReply0Like

Billy Duberstein, Marketplace Contributor
Comments220 | + Follow
"Q1, they tend to pay down their debt which lowers loan loss reserves and increases adjusted EBITDA. However, as our portfolio balances begin growing again we experience higher marketing costs of loan loss reserves which compress margins in Q2 and Q3, but typically result in peak revenues and earnings in Q4."
Net income may fluctuate based on how much the company chooses to reinvest and tax one-offs, but I think I'll trust management on the general seasonality here as they have to reason to lie about it.
2017 NI misses can be largely attributed to the massive Hurricanes Irma and Harvey which hit in Q3.
06 Oct 2018, 11:37 AMReply0Like

1nsight
Comments2 | + Follow
Hey Anton, in drawing parallels across ELVT and its predecessor, how much work have you done on actually comparing the products? One thing that could invalidate/mitigate the regulatory risk is that ELVT doesn't actually offer any payday loans. They deal with longer tenor installment loans, lines of credit, and now this subprime credit card. I haven't gone through the lawsuits but what exactly about the predecessor is being targeted? Is it the fact that they were using rent-a-bank schemes or was it specifically something related to legacy payday loans? As it stands ELVT has some of the lowest rates available among the subprime lenders, and the current CSO/bank partnership model is widely used.
09 Oct 2018, 12:53 PMReply1Like

Anton Tyumin, Contributor
Comments207 | + Follow
Author's reply »

Hello 1nsight,
The article discussed the Plain Green/Elevate comparison - see the section starting with "As seen in the screenshots below..."
"One thing that could invalidate/mitigate the regulatory risk is that ELVT doesn't actually offer any payday loans." The thing is, Plain Green didn't offer typical payday loans either. Its focus were/are "installment loans for short-term borrowing needs."
As discussed in the article, the key value proposition was almost the same:
1. More money and less expensive than a payday loan.
2. More flexible payment structure.
2. Easy, fast, online.
3. Credit bureau reporting.
As you can see with the following WayBackMachine link (May 17, 2014), a typical $700 Plain Green loan's repayment structure consisted of 14 bi-weekly installments. Sounds familiar?
web.archive.org/...
More on Plain Green repayment options and APRs here:
web.archive.org/...
"As it stands ELVT has some of the lowest rates available among the subprime lenders, and the current CSO/bank partnership model is widely used." Right, but "low" isn't enough to protect ELVT from the risk of being classified as a true lender in its relationship with Republic. The reason ELVT CEO is out there making presentations on the benefits of HR 4439 adoption is because this "True Lender" bill would make that risk go away by naming Republic the true lender.
10-K, p. 59: "...To the extent that either the holdings in CashCall or Madden were broadened to cover circumstances applicable to Elevate's business, or if other litigation on related theories were brought against us and were successful, or we were otherwise found to be the "true lender," we could become subject to state usury limits and state licensing laws, in addition to the state consumer protection laws to which we are already subject, in a greater number of states, loans in such states could be deemed void and unenforceable, and we could be subject to substantial penalties in connection with such loans."
10 Oct 2018, 05:25 PMReply0Like

Nat Stewart, Contributor
Comments1160 | + Follow

Anton, are you seeing evidence that the federal regulatory structure will be changing in the reasonably foreseeable future? It is well known that in general regulatory risk is a (perhaps the) key risk in this area - but what specifically is on the horizon at the federal level?

10 Oct 2018, 08:01 PMReply0Like

Anton Tyumin, Contributor

Comments207 | + Follow

Author's reply »

Hello Nat,

At this particular moment, most of the news on regulatory risk will probably come from H.R. 4439. www.govtrack.us/...

There was a Financial Services Committee hearing discussing the bill on Sep 28, with an Elevate Bank Products Director among the witnesses. Mr. Harrison's testimony is available here: financialservices.house.gov/...

Full video from the hearing: www.youtube.com/...

Notably, in its follow-up comment letter to the committee, Center for Responsible Lending (a representative of which also participated in the hearing) is mentioning Elevate as an example of a high-cost lender that uses a rent-a-bank scheme.

From the letter: "The 120 undersigned consumer, civil rights, labor, community and legal services organizations strongly oppose HR 4439 (Hollingsworth), the so-called Modernizing Credit Opportunities Act."

Link: www.responsiblelending.org/...

Finally, I would also note that ELVT's loan quality (and valuation) may also have a deciding role in the stock's medium-term performance.

11 Oct 2018, 10:50 AMReply0Like

Sophocles Sophocleous, Contributor

Comments690 | + Follow

Anton, since you brought up the background check, would you mind telling us a bit about yourself? Based on your LinkedIn, you have 1 year experience at an asset manager and finished school in 2017. Unless you are a genius, I can't see how someone from Latvia who is so young wrote this piece and in such good English.

On the piece, I think you are a bit too pessimistic. Reminds me of all the shorts in WRLD that went on to rise 3x.

11 Oct 2018, 08:20 AMReply0Like

Anton Tyumin, Contributor

Comments207 | + Follow

Author's reply »

Hello Sophocles,

I have a Bachelor's in economics and business, one year at a small capital management firm and a strong willingness to spend most of my time on investing and security analysis. With no privilege of having X decades of experience, I do my best to ensure that learning is a key emphasis for me.

Some of the WRLD shorts I've seen on SA are indeed overly bearish and haven't been timed too well, but I should note that ELVT has a much riskier balance sheet and a higher valuation on P/B basis, which may serve as a margin of safety for a short position. Also, a number of WRLD short theses may have collapsed due to excessive short interest (esp. in 2014-17), which ELVT doesn't have. As of this writing, the stock is down 14+ percent since publication.

11 Oct 2018, 10:54 AMReply0Like

Nat Stewart, Contributor

Comments1160 | + Follow

Anton, earnings look horrible. Excellent call on this one.

29 Oct 2018, 05:08 PMReply0Like

Anton Tyumin, Contributor

Comments207 | + Follow

Author's reply »

Thanks, Nat.

30 Oct 2018, 07:36 AMReply0Like

Anton Tyumin, Contributor

Comments207 | + Follow

Author's reply »

Q3 Earnings Highlights:
"As indicated in our earnings release, it was a challenging quarter for Elevate."
2018 guidance lowered:
Revenue: $790-810mn (Q2) --> $790-795mn (Q3)
Net income: $25-40mn (Q2) --> $10-14mn (Q3)
Diluted EPS: $0.55-0.90 (Q2) --> $0.23-0.32 (Q3)
In Q3, net charge-offs were up 25.1% y-o-y, vs. combined loans receivable growth of 16.3%.
For RISE, net charge-offs were up +15.3% y-o-y, vs. combined loans receivable +7%.
Domestic CACs for the first 9 months rose to $267, up from $232 in 2017.
9m Average loan balances are all down 5.9%, 2.8% and 3,8 for Rise, Elastic and Sunny (which doesn't sound great while the customers acquisition costs are rising). It's unclear why the average loan balances are stated as being the same for Q3 and Q1-Q3 (both 2018 and 2017).
Key issues:
-New customer vintages generated higher charge-offs and loan loss provision than originally forecast (mainly for RISE)
-Margins didn't improve in line with expectations
-Erosion in UK FX rate and increased costs for complaint management
-"Anticipated legal expenses"
The credit quality issues are blamed on the failure to implement the "new underwriting models and technology" on time. Strangely, this hasn't been discussed previously and appears to have confused the analysts.
Despite the filings continuosly stating that "the Company has evaluated the interest rates for its debt and believes they represent market rates," Ken Rees changed tune yesterday and noted: "We are paying above market and are working to get that down to market rates."
On the positive note, some investors may view ELVT's new (rent-a-bank) arrangement with FinWise Bank as a sign of future growth potential for RISE. The bank has another partnership with a fintech lender LendingPoint.
Despite the new partnership, however, ELVT still expects that "RISE revenue growth will continue to decline in Q4 versus the prior year due to slower loan growth."
FinWise Bank's modest HQ (820 E 9400 S, Sandy, UT 84094) can be viewed by following this link:
www.google.lv/...
Meanwhile, the website of All West Bancorp, which is the sole owner of Finwise Bank, is powered by WordPress: http://www.allwestbancorp.com
30 Oct 2018, 07:37 AMReply1Like

Billy Duberstein, Marketplace Contributor
Comments220 | + Follow

I would say nice call on the stock price action, but the stock isn't really down for any of the reasons you mentioned, and all seem to be one-off fixable problems.

1) The new partnership with Finwise took up resources that would otherwise have gone into implementing the new credit model (I guess you could say the company didn't have enough employees to execute all the growth initiatives, a decent problem to have). But this is a long-term positive since the new partnership will expand the company's TAM by about 50% (Rise is half of revenues, will more than double the states offered). that has a one-off legal expense this quarter but is great in the long-run as it opens up a whole bunch of new states.
2) Because the company wants to have the new model in place before it rolls out to the new states and grows aggressively, it is only now starting to implement the model sometime this quarter, which means the effects won't be felt until next year and the company is not aggressively marketing until that model is fully in place, so that explains the slowdown in Q4. It's self-imposed and temporary.
3) at the same time it appears trial lawyers in the UK are shaking down these companies are are causing disproportionate costs relative to the size of the business there (which is only ~15% of revenues). That should also get sorted out over time. this was a 4 million in in the quarter.
4) I'm not sure why you are pointing to the company potentially getting cost of funds down next year by 3-400 basis points as a bad thing or that there is something nefarious there. It's good news for 2019, though not next quarter.
5) Credit is not deteriorating, it's in line with last year, which was the best underwriting year the company has ever had. The new model, which should improve even these figures, has been delayed but will be implemented soon.
6) Domestic CACs are at the lower-end of the long-term model. You can't ding the UK for all its problems but also discount the lower CAC associated with it. Overall CAC still below target.
7) despite the bad second half and lower guidance Elevate will still grow net income on a full-year basis by about 100%.
8) the company is still growing in the high teens, just expanded its addressable market, is showing operating leverage, could lower its cost of funds next year, and is trading at a mid-high single-digit 2019 PE even if you lower estimates.
I'd say the market reaction is symptomatic of all stocks this crazy month, especially technology stocks and financial stocks. Since Elevate is both, the reaction is totally over-the-top.
30 Oct 2018, 02:04 PMReply2Like

Anton Tyumin, Contributor

Comments207 | + Follow

Author's reply »

Hello Billy,

Loan quality concerns and UK regulatory issues have been covered in enough detail.

FinWise Partnership hasn't been discussed by the company before, and blaming a quarter on an issue noone actually expected/was aware of isn't a great thing to do from the stock's standpoint, and I bet that the management understands that. I don't want to speculate about this being a possible evidence of ELVT hedging its RISE product against any issues with Republic Bank, but I wouldn't view this as a distant possibility either. Given the company's general eagerness to disclose positive news via press releases, it's not clear why they chose to announce its "employer award" and skip this.

This might indeed serve as a revenue boost in the future, but remember that "RISE revenue growth will continue to decline in Q4 versus the prior year due to slower loan growth."

On the cost of funds - I did not state that the possibility of decreasing the rate is bad (as you imply). I just find it utterly strange that the rate that's constantly been referred to as being "a fair market rate" has suddenly been reclassified as an "above market" one. As you already know, I also continue to have reservations about the company's ability to refinance to 11% or lower, and no future funding provider will completely disregard ELVT's share price dynamics.

On the credit quality - "New customer default rates slightly worse than targets" may not sound too bad, but you shouldn't take this out of context considering the stage of the business cycle the US economy is currently in. 2018 vintage doesn't look too great on the slide 10. investors.elevate.com/...

Are you comfortable with flat/stable CACs and declining average loan balances?