Company Name: Navient Corp
Company Ticker: NAVI US
Date: 2015-09-29
Event Description: Deutsche Bank Leveraged Finance Conference

Market Cap: 4,398.63
Current PX: 11.76
YTD Change($): -9.85
YTD Change(%): -45.581

Bloomberg Estimates - EPS
Current Quarter: 0.483
Current Year: 1.854
Bloomberg Estimates - Sales
Current Quarter: 659.000
Current Year: 2628.500

Deutsche Bank Leveraged Finance Conference

Company Participants

- Unverified Participant
- John F. Remondi

MANAGEMENT DISCUSSION SECTION

Unverified Participant

Good afternoon, everyone. I would like to welcome on stage Navient. Navient is the leading loan management servicing and asset recovery firm with $300 billion in assets – managing $300 billion in assets for over 12 million Americans.

Today from Navient, we have Jack Remondi, President and CEO; and Joe Fisher, the Vice President and Head of Investor Relations. Jack?

John F. Remondi

Thank you. Afternoon. So this afternoon, I want to cover some of the highlights of the Navient's story and share couple of insights and some of the issues going on, on the amortization of our loan portfolios particularly as it relates to our ABS trust and then also talk a little bit about the regulatory environment.

So, it's been about little over a year since we separated from Sallie Mae in 2014. And at that time, we presented the investment thesis for Navient. It was driven by the fact that we have a sizable student loan portfolio that will generate predictable value in terms of cash flows, both in terms of the size as well as the timing of those cash flows. We felt that we had the ability to add to those cash flows, or to this foundation through portfolio purchases of both FFELP and private credit student loans.

We looked and stated that we had an intention of growing our fee-based businesses through organic channels and through bolt-on acquisitions, one of which we completed earlier this year. And finally, it was our plan to return excess capital to shareholders through dividends and share repurchases while continuing to service and reduce our unsecured debt securities through maturities and debt repurchases. And I'd say most importantly, this thesis remains intact today. The difference is that today's market values create additional opportunities for us to add to this value through debt repurchases and share repurchases.

The foundation here is really driven by a very conservative long-term funding model. We look to finance the vast majority of our student loan assets through term ABS liabilities. Today, over 85% of our liabilities are structured non-recourse liabilities, and 75% in total are what we call term past-due structures.

Student loan acquisitions particularly on the FFELP side and including any acquisitions we make from existing securitization trust through our optional clean-up call acquisitions are funded with proceeds from limited purpose asset-backed facilities. So they are not consuming liquidity that would otherwise be available to service our unsecured debt.

In the sizable and predictable sources of unrestricted cash flow from servicing fees, from our trusts, which come up at the top of the waterfall, our excess spread from our student loan trust which are paying consistently and can be monitored through our reporting processes. Earnings from our unencumbered loans and our fee businesses, all of these combine to provide a sizable source of cash flows that's more than sufficient to service our unsecured debt. Financing proceeds provide an additional and sizable source of liquidity for the company. This can come from the ability to securitize our unencumbered student loan portfolio, which currently – as of June 30, stood at $5.7 billion.

It can come from releasings or financing some of the existing over-collateralization and our securitization trust which stands at $11 billion, or even proceeds from unsecured debt issuance, which has been totaled – year-to-date we've issued $500 million in 2015 and we did just under $1.9 billion in 2014. In summary, we believe the financing structure here puts us in a very good position with a large and predictable series of cash flows to service our unsecured debt.

Our debt maturity structure is displayed on this slide here. And I think one of the things – the big point is that we have a very long and successful track record of evening-out these debt maturities and reducing our unsecured debt in total. So since 2006, we've reduced the total amount of our unsecured debt outstanding by $32 billion, including almost $14 billion through open market transactions, either purchases or tenders of our unsecured bonds. Our goal has been consistent in this area. And one that we've been active at managing is to spread out or even out our debt maturities and to reduce the remaining maturities to match the cash flows that we expect to generate from our portfolio over the next 20 years.

As this chart shows, we've been steadily reducing our debt faster than the amortization of our tangible net assets. And it's important to note that this took place while shareholder distributions were increasing. So you can see that our tangible net asset ratio has improved from just over one time, when we were an investment grade-rated company to over 1.2 times today. And the result is a stronger balance sheet overall, and one that has higher sources of liquidity than we did as a single A-rated entity.

And while we'll continue to be a regular issue in the unsecured markets going forward, our plan is to do so while maintaining this more conservative profile. So 1.2 times is kind of the target that we're looking to maintain, and that'll drive how we distribute excess liquidity between debt holders and share repurchases.

The value of this company – the foundation of the enterprise value is built on the stable and predictable cash flows that will come off of our $130 billion of student loans. We're expected to generate over $33 billion in cash flows net of our structured debt service activity. And the present value of these cash flows, we believe, is conservatively worth more than $20 a share.

More importantly, this cash flow covers is more than sufficient to cover all of our unsecured debt service requirements. Current market conditions, including questions raised by the rating agencies over the timing of cash flows in our ABS securitizations do not impact us. So a downgrade of any bonds as an example, something that we're working to not have occur, but if it did, would not change the funding costs or the timing of the expected $33 billion in cash flows.

Ironically here, we have really a situation where a slower prepayment speed is causing the loan portfolio to generate more cash than originally forecasted. And what we've tried to do here is to show that a 1% slower CPR would actually add about $700 million to the $33.2 billion in cash flow.

This cash flow is also not just a projection of future net income that will be derived from the portfolio. $11 billion of this cash flow is in the form of existing over-collateralization in our securitization trust. $5.7 billion is the principal balance of unencumbered student loans that will get paid over time, and $5 billion comes from the servicing fee that we extract or earn from our securitization trust internally at the top of the cash flow waterfall.

So, this is the dominant issue that I believe is impacting our debt securities and equity today. The market impact, we believe, is disproportionate due to a misunderstanding of the size and the impact of this issue overall. And we have been and will continue to be very active in our efforts to address and eliminate issues here by working with the ratings agencies to make sure that we are – stress test our model based on the potential for these things to happen versus items that may or cannot take place.

So, one of the things that we've tried to help do is also explain not just to the rating agencies but to create a greater understanding with investors as to the size of the issue here and when issues would likely take place. So as of today, Moody's has placed $34 billion of our ABS bonds on watch. $3 billion of that $34 billion has a maturity date inside of five years. And we've been working to reduce that number through optional call activities. So actually, that $3 billion was as of August 31st. Today that number is $2.2 billion.

We've also tried to illustrate what the potential size here is of different outcomes. And so when we run our cash flows embedded in these securitization trust at a 0% CPR, a rate that has not happened in our securitization trust, we would project that less than $50 million of bonds that are on watch in the next five years would be outstanding. So of that $3 billion that Moody's has identified as a area of concern, only $50 million would be at exposure.

So what are we doing to try to address that? As I said, we're working closely with the rating agencies to understand their concerns, and more importantly, their models. We've helped to ensure an accurate assessment of some of the assumptions that can take place and their resulting impact on cash flows. So we want to make sure that as we look to understand what's driving the prepayment speeds here, we understand that as we add stress assumptions that we're accurately estimating what is legally possible to take place.

We've been actively exercising call options. We've done $1.9 billion of call options since 2014. We're amending deals so that we have the right to call an additional 10% of the original balance of the bond. We've amended 33 trusts to date and we're also working with some investors to extend the trust maturity dates to take this issue off the table. We believe the size here is manageable and that we have the tools available to make sure that we don't trip up against any of these legal, final maturity date issues.

Credit performance continues; a trend of continued improvement in our portfolio. What this chart shows is the performance of our private loan portfolio across various risk segments that we have placed our loans into. I want to point out the fact that, one, our performance is really driven by the low-risk component of the portfolio which makes up almost 90% – low and moderate risk which makes up over 92% of the loans outstanding.

This is a segment that really speaks to the strong and consistent profile of our customer base. It's a customer that has applied to attend a four-year educational institution, obtain a degree, and the result is that higher income, higher job prospects, lower levels of unemployment create the ability to repay these loans consistently over different economic periods. You can see on the bottom-line there that even during tough economic periods, while default rates did increase, they did not increase materially.

The non-traditional segment is the piece I'd like to spend a little bit more time out here. This is a designation that we made on these loans back in 2008. And it really represented a segment of our lending activity that was different than where we had traditionally lent. These were our customers who are attending different types of schools and really represented a mixture of demographics in terms of age more than anything else. So these were not your traditional high school seniors coming out of school looking to finance a college degree. This portfolio was originally just under 15% of our total book. It's 8% today. And one of the things that's happening here is as this portfolio is migrating and becoming more seasoned. Significant segments of this portfolio are demonstrating very consistent and strong payment behavior. So over $1.2 billion of the $2.3 billion in this portfolio, for example, is both current and has made more than 25 monthly payments on their student loans.

The bottom-line is that this portfolio is performing actually better than the traditional portfolio performs on a whole. And it's a good example of why we believe we'll be able to access term financing for this segment of our portfolio going forward.

And consistent with prior experience here as we continue to see the portfolio season, and if you look at some of our investor slides that are in our quarterly decks, you'll see that as borrowers move from making 12 payments to 24 payments to 36 payments, default trends consistently fall as those customers have success and they typically fall by about – they cut in half. Their typical default rate drops by half for every 12 months payment the borrower makes.

Our performance and our ability to maximize our cash flows from our student loan portfolio is really driven by a solid servicing platform that creates value for our borrowers, the Department of Ed and our shareholders. It's a large scale operation, very cost-efficient and delivers superior performance through data driven strategies. An example of our ability to add value here is, recently, we've converted $15 billion worth of FFELP loans that we acquired in the secondary market that were serviced by third-parties on to our servicing platform.

And in 2006 and beyond, we expect to see significant cost savings as a result of that, over $15 million a year in reduction from what we're incurring in 2015. And more importantly, we expect to see significantly better performance on the loans. Our customers, for example, we service roughly 30% of all federal student loans outstanding and our customers default at a 48% lower rate than all other servicers combined.

The regulatory environment here and even in our asset-recovery business is a particular interest and subject to further development here. Over the last two years we've been subject to ongoing exams from the CFPB, State Attorney Generals and other regulators. We have responded to their list of concerns and issues that we have here. Some of the issues that have come up cover Department of Education rules and regulations. And we certainly will continue to work with the regulators to produce a better outcome, our solid outcome for our customers.

Even today there was further discussion on this particular topic from the CFPB really looking for servicers to work with their customers to make sure that they understand the different repayment options that they have available to them. And this is something we're particularly proud of, the success we've had in this area. As I said, our customers default at a 48% lower rate than all other servicers in the country, and that's done as a result of our very targeted data-driven strategies to make sure that we connect with a customer when they're having trouble paying their loans, and are we able to work with them to avoid default.

And the statistics here are really nothing short of amazing. Nine out of 10 times when we connect with a delinquent federal customer, we're able to get that borrower into a plan that keeps them out of default. So nine out of 10 times that kind of success takes place. Our challenge has really been connecting with customers who are delinquent, who are not responding to our outreach efforts.

And fully 90% of the defaults that we see off of our servicing platform each year are from customers who had zero contact with us during the 12 months that takes to default. During that timeframe, we would typically attempt to connect with that customer 300 times through mail, phone calls, text messages or e-mails. This is an extensive effort that we make to help make sure that customers are aware of the different repayment options that they have available to them. And we look forward to working with others in the industry to make sure that there's a full transparency in the solutions that are out there.

Our asset recovery business is similar in the sense of our servicing platform drives our results here. It's a strong business franchise that was originally focused on education loans. It's backed by sophisticated systems and strategies that deliver excellent results for our business partners and customers. And we've been working over the last couple of years to expand this business into new asset classes outside of the Department of Ed. Some of these areas of expansion include state and municipal work, bill presentment and processing, and medical payment collections. It's really a bill presentment and processing business. And over the last year, year-over-year, we've seen an 88% growth in the revenues from our non-education related fee-based businesses here.

Our focus is on looking at areas where we see significant opportunity to grow. This will be places where we would have small market share, with the businesses undergoing some transformation of moving primarily from in-sourcing to outsourcing solutions where we can add value through better and lower cost processing environments. We're focused on areas where we can grow organically and also through opportunities where we can add bolt-on acquisitions as we did earlier this year of a platform in Texas.

I think one of the issues driving some of the student loan topics that we read in the media and even on the regulatory front is that the narrative here has discussed student loans or presented student loans in very broad generalizations that makes insight as to what's going on difficult or impossible. For example, we have – the average student who comes out of a four-year college degree granting program leaves school with about $27,000 worth of debt. That translates into a monthly payment of about $315 or roughly $60 more a month than what a borrower graduated with in 2012.

That statistic doesn't really jive with what we read in the papers about student loans, right? The average media story covers a borrower who owes $85,000, three times the actual average, and only talks about borrowers who are struggling to make payments. It doesn't talk about the significant portion of borrowers over 90% that are successfully managing their student loans each and every month.

As a result, we have looked at the program and made a series of recommendations on the policy side that we think will help improve the student loan programs for all borrowers going forward. First is we think it should be a priority to educate customers before they borrow. Today, solutions are really designed to help students after the money has been lent and spent. And we believe that helping students and families understand the financial obligations they're taking on, what the aggregate amounts that they will need to take on in order to earn their degree would be, and to put that into perspective based on their chosen field of work. We've seen other practices in this area have meaningful results. We're just simply educating consumers about how much debt they actually have today and what it's going to be based on the amount that they have requested, has caused them to step back and reduced the amount of loans that they're choosing to take on in the next academic year.

Simplification is a key requirement as well. A huge challenge to helping customers understand that the solutions that are available to them is the fact that there are so many different repayment plans and options available often with similar sounding names. So today, there are 15 repayment program, eight forgiveness programs, and over 30 forbearance and deferment options. Some of them have names like income-contingent repayment, income-sensitive repayment. No customer is going to understand that those are two distinct programs with very different terms and conditions associated with them. Even as new programs are added, we need to simplify the application process and the renewal process so that it doesn't discourage borrowers from completing the forms.

For example, the most recent program that is being rolled out called REPAYE, the current application it's in draft form and to be released later this fall, runs almost 15 pages long. That's a unnecessarily complicated form that we believe can be simplified to promote more engagement from consumers and enrollment activities.

We need to promote repayment. Too often the solution is defer. And we need to make sure that customers, as they're choosing to defer their loan payments, understand the financial consequences of that. Taking longer to pay your loan means you'll pay more in total finance charges over the life of the loan, even if there's a loan forgiveness option or potential at the end. And we need to encourage contact. As I said, 90% of the customers that we service that end up in default each year has zero contact with us during that full year it takes to default. We believe that contact works and we should encourage it.

So in summary here, our existing $130 billion portfolio really forms the foundation of the enterprise value of Navient. $33 billion in projected cash flows at a discounted value is worth more than $20 a share today. The sizable and predictable cash flow create access to funding and liquidity to service our unsecured and structured bonds on both sides. Our efficient and high performing operations are transferable to new asset classes to create additional value. And we believe the current market environment has created a massive discount to true value, that's true on our ABS securities, our unsecured debt and our equity. And we're creating liquidity and working to create liquidity to capture these opportunities and add to the enterprise value of the company.

And with that, I'd be happy to take any questions that folks have.

Q&A

<A - John F. Remondi>: Yes?

<Q>: [Question Inaudible] (25:48-26:14)?

<A - John F. Remondi>: So, most of the work that we do with customers and most of the transactional work that drives our operating expense here is helping customers who are delinquent or having difficulty making payments on their loans. And one of the misperceptions, I think, is that how we service loans that we are financially better off by doing less, so that customers end up in delinquency or default in that process.

Under our Department of Education contract, our lowest – they pay us the least amount per month to service a borrower's account that is in a delinquent status or in a forbearance status. The highest fee we get paid is for a borrower who is in a current status. And it can be more than three times as much to be paid for a borrower who is current. A borrower who is current also is consuming less internal resources for the company. They're not someone we're reaching out to contact several times a month, to remind them of their payment obligation and get them to sign up to a repayment program, we're not processing forms or other activity on that account base.

So we believe that the way the current program is structured, we're economically incented to work with customers to help them on that front. And I think our results really speak for themselves, right? I mean, if our default rates are 48% lower than the industry average, then nine times out of 10 we're able to resolve a delinquent customer – when we contact a delinquent customer, we're able to resolve that customer's situation and keep them out of default. Those are the strategies that we think are most important and what we're doing to work on that front.

Now, there are other things that we can do to help make the process more transparent for customers and improve contact rates and improve outcomes. Those are things that we believe we can develop and implement and ultimately produce better results and better revenue streams for the company.

<Q>: [Question Inaudible] (28:18-28:36)

<A - John F. Remondi>: Sure. So, last quarter – second quarter, we talked about a portfolio of customers that had moved in and out of an in-school deferment status several times during the recession. And as they finally came into repayment, we experienced higher default rates than we had typically seen out of customers that had traditionally use deferment. In our private loan business, we make loans principally to students attending four-year colleges. And so, deferments were used by those students who graduated – returning to school to get a graduate degree. And our best performing segment of our private loan portfolio and this is true on the federal side as well, bar none our graduate school students.

One of the ironies of student loans is that higher debt balances generally mean better loan performance because it means you've got a higher degree. And the income prospects and job prospects are improved dramatically with each year of education. What we did when we saw this portfolio trend last quarter is we took a look at our entire portfolio for loans that might have similar types of characteristics. And because of our reserving methodologies, at least the two-year window, in many cases it's the life of loan estimate of losses, we were able to take the deferment segment of that portfolio in reserve for all in the second quarter.

So we believe the issue is fully contained. And that you will see delinquency and default performance improve materially for the balance of this year. And that, obviously, will have an impact – a positive impact on the provisioning expense.

John F. Remondi

Okay. Great. Thank you very much for your attention today.

Unverified Participant

Thanks, everyone.