Affirm Holdings, Inc.
CFO Fireside Chat
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Introduction

Robert Henry Wildhack
Autonomous Research LLP

Good afternoon, everyone, and thanks for joining. My name is Rob Wildhack, and I cover Affirm for Autonomous Research. I'm very happy to have Michael Linford, Affirm, CFO, joining me for a conversation today.

Michael has been the company's CFO since 2018. So he's led the company through significant growth, the IPO process. In the last 1.5 years or so as a public company and the current market environment. Michael, it's great to be with you. Thanks for joining. I know you have some prepared remarks to kick us off. So why don't you go ahead?

Michael A. Linford
Chief Financial Officer

Thank you, and thanks for having me and hosting this event. I thought I would take a second for everybody and just remind our investor base, and in particular, our retail investor base through this channel, this event is for about what we're up to at Affirm.

Because you're right, the market has been quite volatile. And I think the forest is being lost just a little bit through the trees. So Affirm was founded a decade ago. And our mission has been the same since the day we were founded, and that's to build honest financial products that improve lives.

What we saw was a very broken system. A system where consumers were either overly constrained in their spending power and using debit or their only alternative was to go towards a product that we thought created a lot of consumer harm and misaligned incentives and that's the revolving credit card debt.

So, we saw a broken system and we decided to go fix it. The past 10 years of the company's journey has all been around bringing these honest financial products to solving the consumer harm created on revolving debt products, taking away things like late fees and deferred interest and revolving debt and replacing them with an honest and transparent way for consumers to get the things that they want and need.

So here at Affirm, we think that credit is a good thing. It makes commerce happen. The credit card model, though, is the thing that needs to be poked at and changed over time, and we're very excited to do that. And that's why you've seen so much growth in our space. You see the consumers are changing the way in which they behave and engage with credit products in a very fundamental way, and our growth over the past several years has benefited from that. And that trend will continue in any economic environment.

We think we're best positioned in order to capture that change in consumer behavior because we bring a full suite of products to consumers that allow them to pay for things over a very short period of time as short as 6 weeks or a very long period of time as long as 60 months. Our ability to create different products to serve different use cases in the end, positions us very well to be the winner of what we consider to be a very fundamental change in consumer behavior.

And we do all this by creating very attractive assets. So when we create a transaction, we're able to create a loan that has a lot of economic content. We call that our unit economics. And because we can create very profitable units as we scale, this business has very strong cash flow generation profile that we think will reward shareholders in the very long run.

So with that intro out of the way, I'm very pleased that we can provide a voice to our retail investors and answer their questions here today. So Rob, I'll turn it over to you.

Question and Answer

Robert Henry Wildhack
Autonomous Research LLP

Yes, absolutely. And our first question does come from a retail investor via Say Technologies is from Andreas T., who asks, Apple announced that they will soon launch a BNPL service, the Apple Pay Later. As a result, Affirm stock took a hit and Andreas would like to know how the company plans to respond to that upcoming or incoming competition from Apple?

Michael A. Linford
Chief Financial Officer

Yes. Thanks for the question, Andreas.

First take a step back. I think this product was rumored to be launched 1 year ago. I believe it was middle of the summer last year when this product was first rumored. I think what you saw at the announcement at the developer conference for Apple, was more detail, although we don't actually know yet exactly what it will look like. And so it's very early.

I don't want to speculate too much about what the product will be. That being said, we think a couple of things are really important. Going back to how I started the conversation. This endorsement of this novel payment method by one of the world's leading companies in Apple we think is just another data point on the inevitability of the shift away from traditional payment methods and towards products like ours.

And you can think of it as this product going mainstream or you can think of it as just another data point along this journey, reflecting the fundamental shift in consumer behavior. So, I think in that aspect, it's a good thing. It reinforces the idea that there's a very big TAM out here. I think for investors, they should view this as, wow, even Apple is validating this as a payment method and spending time to integrate into their wallet.

With respect to what it means for us specifically, there really isn't a lot of overlap with the planned implementation that we understand and what we do today. So, we integrate with some of the world's leading technology platforms and merchants from Amazon to Shopify to Walmart. And all those integrations are very specific and custom and not something that will be subject to a ton of competition for wallet-based BNPL offers.

We view this very similarly to other wallet-based BNPL offers that exist, whether that's with the likes of PayPal or even with some of the offers that some financial institutions provide on their cards. These are all really important features for consumers. And we're really excited that Apple has gone a step further and endorsed our no late fee approach. This is an approach that now Apple, Amazon and Shopify have all validated as being a critical part of this offering.

If you think about the player most likely to win on the integrated side in a no late-fee environment, I think we're really the only one. And we view our chances to continue to grow and build a very big business there to be quite strong. Stepping even a little bit further back, this market is going to be enormous.

The current estimates are BNPL was something on the order of 3% of U.S. e-commerce last year. We think that number over the next 3 years has a chance to triple. And the kind of growth that you're going to see in that market means there's not going to be 1 player and 1 winner. And just as we have been able to grow despite the launch of various competitive offerings, we feel really good about our competitive position and growth going forward and very happy about the validation, both on the no late fees and on the model itself that Apple brings to the market.

Robert Henry Wildhack
Autonomous Research LLP

Right. And as I think about it, there are also some key differences between your offering and Apple's, those are both on the back end or the front end presentment side, however you want to call it. Can you talk a little bit about those differences and why they're important?

Michael A. Linford
Chief Financial Officer

Yes. So first of all, our product offering today offers what we call Split Pay, which is similar to what we think Apple's first Pay later offering will be. And it's also similar to what AfterPay has out in the market. And that is dividing your purchase into 4 small bites. I think that's traditionally what people say BNPL, that's what they mean.

But our product obviously goes much broader. We also do monthly installments all the way out to 60 months. And so when we go to work with the merchant, we try to get very deeply integrated and we bring whatever products that we can to help grow their business in the best way possible while delighting consumers and giving them access to credit.

We have a product we call Adaptive Checkout that actually combines the magic of pay in 4 with the value of installments in terms of deciding and helping consumers see the right offers. And these kind of up funnel, as we call it, or product display page offer presentation are things that are unique to highly integrated relationships.

What we know is that the further down funnel you are, i.e., the culture of checkout you get the weaker the conversion impact for the merchant is and the weaker the credit selection is. Our ability to effectively market the right ways with our merchants is a function of our integration and we're really good technologists. And so we've invested a lot of energy over the past decade in building some very good and deep integrations that we think allows us to bring the full suite of products to bear that the kind of experience you get in a consumer feature in a wallet just can't match.

That being said, I don't want to underestimate the impact that the kind of consumer wallet like an Apple might have. It's a really important and critical consumer feature. We think about that as more of a consumer offering inside of the Apple Pay system as opposed to a merchant offering driving compelling conversion increases and average order value growth on their site.

Robert Henry Wildhack
Autonomous Research LLP

Got it. And just to stick with competition a little more. As you look at the competitive landscape, how do you judge who's winning and who's losing? And how would you recommend that we as analysts or investors track or assess who the winners are?

Michael A. Linford
Chief Financial Officer

Yes. I think the most important thing is to look at the results of the businesses that you can. Our growth rate is obviously very high. Last quarter, we posted near 97% growth on GMV taking out our largest partner, Peloton of the comparable. And that kind of growth is really unmatched amongst our competitive set.

And the reason for that is our superior technology, our underwriting and risk management capabilities as well as the distribution we've earned with our partners like Amazon and Shopify. I think you should first look at the results combined with who's best positioned when you're evaluating that.

I would steer clear of any of the data services. There are data services out there that look at some of the wrong measures to try to estimate. They've been wrong, I think, exactly 6 out of 6 quarters we've been public. And so I would steer clear of those sources. It's actually the case that I haven't seen any third-party data that accurately predicts market share. We have our own internal estimates and track it quite closely.

But I would look to things like the consumer frequency and GMV on the platform as a good indicator of the overall scale of the various networks. And then I would look at the unit economics. Because I think what you're going to see in the next 1.5 years, certainly as the market pivots out of this goldilocks condition of low rates, high growth and tons of liquidity is a real separation from those who can manage risk and manage the unit economics and those who can't.

And I think our ability to command industry-leading unit economics. Last quarter we printed 4.7% of GMV. Combined with that very strong growth that we're printing is just unmatched in any of our competitive set. What you're seeing is some competitors pull back on volume and some competitors continue to try to make up their profitability and negative unit economics. And we don't think either those 2 strategies work.

Thinking about looking at who's winning, look at who's growing fast, while still generating really good unit economics because that's what makes the business robust through any cycle.

Robert Henry Wildhack
Autonomous Research LLP

Yes. And just to double click on that a little bit. You mentioned some peers have recently seen their growth slow or had to pull back. What do you think is driving the difference between trends at those firms versus the trends at Affirm where you guys have really just kept growing.

Michael A. Linford
Chief Financial Officer

Yes. I've been picking on some of the people who like to short the stock recently in various investor forums because I think they want there to be a real flaw in our business model. They want there to not be an advantage that we have because they are a little uncredulous that you can come along and you can build a business that puts the consumer first, that doesn't take advantage of them, that creates aligned incentives across the merchant and consumer and still do it with really good unit economics. They want that to not be true.

Unfortunately for them, it is true. And I think the biggest difference for us is the approach that we've taken going back to the day we were founded. We think about underwriting as a very important thing to do on every transaction. We don't think about creating systems of carrots and sticks in terms of incentives and disincentives. We don't have late fees and reactivation fees and all the other things you might see some of our competitors do.

And because we don't have those things, we have to make a very honest decision at the moment we approve a transaction about whether or not that consumer will repay us. And we have 7 years or so of meaningful lending activity in the past 3 years, in particular, a ton of data on what the probability to repay is.

We started sharing with investors a lot of additional disclosure and data around the performance of our models. There's a chart in our last investor presentation, I'd encourage everybody to take a look at. That shows what we call the steepness of the underwriting curve, and that's a lot of jargon. Let me try to explain that. What that means is we can estimate the losses on any given scored set of consumers.

All credit scoring really comes down to 1 basic idea, which we are trying to sort risk. And if the risk was flat, that is to say completely random and any consumer had the same risk as the next person then sorting doesn't really add a lot of value. And you don't really have much advantage. And if you want to try to manage credit risk, there's not a lot you can do.

I think a lot of our competitors have a very flat credit scoring because they don't do the same things that we do, and I'll come back to that in a second. But the thing that we do and see in our data is a very steep underwriting curve. And that means the kind of the least creditworthy consumer that we approve is the most lossy and the losses reduce substantially as you reduce the number of people that you approve.

And what that means for us is that we're able to pick the level of loss that we want, and we could be surgical and tactical about it and deliver outsized results. Our competitors are without those scales. They have to just use blunt force tools and substantially decrease the amount of risk that they take in order to manage the risk.

In other words, we can spot the least likely to repay better than anybody. Now how do we do that? Well, we do that by having one of the world's best data science teams taking on all the credit bureau data that we can and apply it towards really advanced models. And then we do that in the context of transaction level underwriting. So we're really good at underwriting with our data science and machine learning, and we have the secret advantage where we approve things at the point of sale on any given transaction.

And so the same consumer might present different credit risk depending upon the item that's being purchased or even the time of day that something is being purchased. So my favorite example to talk about -- and part because it's a little funny, but also because I think it shows you the value of thinking about transaction level underwriting.

We get to approve transactions, taking onboard all of that data that we have. One of the signals we look at is the time of day. And it turns out that people at 2:00 in the morning are higher credit risk than people at 2:00 in the afternoon. That doesn't drive outsized results because not a lot of applications happen at 2:00 in the morning. But when they're happening there, it's a higher risk transaction.

As a transaction level approver, we can be a little bit more careful about the credit that we extend in those times because it's very possible that consumer doesn't really understand at that moment what it is that they're taking on board. And that kind of signal is something that we can bring into our models in addition to enriching the data you see on the consumer with respect to their credit bureau file and all of the different obligations that they have.

And we've taken the view from day 1 that we're going to do that underwriting thing for all of our transactions. So we look at a Split Pay transaction that's kind of very short in duration, and we say it's a different risk profile, but still requires underwriting whereas the longer-term stuff, we, of course, underwrite very carefully and are very careful about the risk that we take there.

And this view that we have had, since day 1, has honestly created some friction vis-a-vis competition in the past. 1 year ago, when the only thing people were focused on was growing at all cost. It created a conversation with merchants where we had to explain to them that we were going to be more careful on credit. And that was a really important thing for us and that we were going to underwrite transactions.

Furthermore, we call these transactions loans. And these are all things that are anathema to some of our competitors. They don't want to think these are loans. They don't want to tell consumer, it's a loan. They don't want to do the underwriting process because that just sounds like work. And look, it is work.

We've said this before. I think it's a really important point, that complexity that we've chosen to take it on, the idea of underwriting every transaction. That's a moat. That is a thing that our competitors can't do. And you're seeing it play out right now. You're seeing our competitors have to be substantially lower growth than we are right now because we have done the hard thing and always have.

And so again, my apologies to those who like to short the stock. But the truth is that we actually have something that's very different, and we have these advantages that serve us quite well in any environment, but in particular, in the current environment of increasing macroeconomic stress.

Robert Henry Wildhack
Autonomous Research LLP

Got it. That's really helpful. To change gears a little bit, your updated outlook to be adjusted operating income positive as we head into fiscal '24. It was well received by investors and some fintechs are prioritizing profitability by cutting costs, trimming investments, freezing hiring.

Well, you're actually continuing with all of those things, too. So can you talk about what's behind that? And can you also touch on cash flow, too, in addition to adjusted operating income?

Michael A. Linford
Chief Financial Officer

Yes. Very good questions. So we announced at the end of -- on our earnings call that we would be profitable on a sustainable basis through the end of the next fiscal year. And we measure that profitability using adjusted operating income. It's really similar to an EBITDA type measure that you see a lot of other companies use.

We don't use that measure because obviously, the interest expense for our loans is a real important part. We would consider that to be a cost of providing any loans we would never exclude that. And so we think about it as our kind of GAAP operating income and then there are a series of adjustments we make mostly around stock-based compensation, amortization of some warrants that we gave a couple of key partners and then some D&A associated with capitalized software.

So we've committed to that number to be above 0 on a sustainable basis by the end of next fiscal year. For what it's worth, we were profitable on that basis in our fiscal Q3 and feel really good about our ability to continue to scale wisely. This is a really important point for investors to understand, and in particular, retail investors. Our unit economics are very strong. I mentioned before that last quarter, we made 4.7% of all our GMV inside of this measure we call revenue less transaction costs. That's kind of like the profit we have in our lending.

That number is really strong and robust, and we've committed to being within the 3% to 4% long term with that number. That generates a lot of positive margin in the business that we then reinvest in things like engineering, G&A and sales and marketing. The engineering investments, in particular, are one that the company is going to continue to be very aggressive on.

We have the opportunity of a lifetime ahead of us. The market is very big and growing very fast, and we want to be well positioned when we get through this economic cycle to be well ahead of the pack. We love the hand that we have right now, but we know that we have to keep the pressure on product development to maintain that lead. And if you think about the kind of pedigree we have in our company and being founded and run by Max Levchin, we're going to keep investing in technology.

The other lines that kind of variable margin gets deployed against are things like sales and marketing and G&A. And those are lines we expect to show real leverage, which is just CFO talk for, they're going to grow slower than the rate that we're growing the margin of the business.

And why is that? That's -- it's partially because the top line is growing as fast as it is. It's also because of the rate at which we added human beings to our business, human capital, was really fast last year. We more than doubled headcount over the past 18 months. That's not a sustainable act to do independent of the economics. It doesn't matter even what the P&L looks like. That's a lot of humans to add to the team.

We do expect that growth of headcount to moderate. But that is not to say we expect to reduce hiring or freeze hiring like our competitors are doing. We do have a lot of belief in the value of the business we're building, and we're going to keep hiring the team to go tackle that opportunity. We just are recognizing in our commitment here that we can't possibly grow that as fast as the top lines in the business are.

And then you mentioned cash flow. The reason we use our adjusted operating income measure is it's the best proxy for an operating cash flow measure with a couple of really big asterisks on it, that we have internally in how we operate the business. The big asterisks are that I mentioned before, the D&A line inside of the adjustments does have some cash flow in it.

And in other words, we have real cash out that is amortized and thinking about operating cash flow, it would be fair to add that back out or back that out. We would expect that to continue to be on a very similar order of magnitude that you've seen it in the prior periods. And of course, as my lawyers remind me, you should review all of our reconciliations to the appropriate GAAP measures posted on our IR website.

But what that means, Rob, with respect to when do we expect to be generating cash flow is think about that as slightly lagging that adjusted operating income measure with respect to true free cash flow, but not far off. We've talked a lot about the amount of "dry powder" that we have that enables us to be very aggressive in building our business right now.

The reason why we're so confident that's dry powder is because we don't think very much of that is really tied up in achieving cash flow positivity in the business. We think that that's something that's very close in.

Robert Henry Wildhack
Autonomous Research LLP

Can I infer that a slight lag there is within 12 months?

Michael A. Linford
Chief Financial Officer

I definitely don't want to make any additional commitments, but I would think about it more as a dollar than a time basis. In other words, the timing of getting to 0 isn't all that interesting because what we're not doing is trying to run this business to maximize the level of profitability. That's not the goal. The goal is to limit the amount of cash that we need between now and whenever that future date is so that we're not reliant upon any dilutive activity in order to grow the business.

And we don't feel like we need to be. We feel like we're so well capitalized right now, and we wanted the market to share in that confidence that we have.

Robert Henry Wildhack
Autonomous Research LLP

Got it. Got it. Another question that's come in from Nathan M. – the question is, with having merchant rate fees on top of the processing fee that deeply cut into company margins, do you see a race to the bottom occurring with these fees as competition heats up in the coming years in the BNPL space?

Michael A. Linford
Chief Financial Officer

It's a very good question. I would say in our first 12 months of being public, I got this question 17 different ways. We actually have a chart now that we include in our earnings supplement, which Marissa is posting for us here. And I would really encourage folks who are wondering about our ability to continue to demand high merchant fees to spend some time on this chart.

So, the top line on this chart is what we call our core 0% long-term loans. That is programs that extend 0% APR offers to consumers, 48-plus months, oftentimes well north of 24 months. That is a very different product, but obviously, as you can see, it's a substantially higher merchant fee. Well, it's a higher merchant fee because the product is different.

You then go down to the Split Pay line. The Split Pay line is, by far, the most competitive part of the BNPL market. When people talk about BNPL, they really are focusing on Split Pay. That's the product that Apple launched with, that's Afterpay's core product, and that's the product that we launched with Shop Pay installments. It's a very important part of our total business, but it's only 1 part.

And one of the ways that we're very different in our business is we have lots of different business lines. But you're never trading off that product with a longer term 0 or an interest-bearing level. And if you see that line is actually going up and to the right over the past several quarters, if you see that small dip in fiscal Q1 2022, that's a function of a promotion we ran with Shopify as we launched the product.

So I'd like to smooth it out, and I'm looking at this chart. And we're printing really robust Split Pay MDRs. And that is something that we've done despite the peak competition. The competition was extremely high last summer when the public equity markets were rewarding any and all of these business models in a really attractive way. Since then, you've seen people really come down quite a bit.

And we think that as folks get more risk off and more careful, the competition will moderate a little bit. But, that being said, you have the future threats of other wallet providers coming in and attempting to compete with us. But we like our position here. We think that because of the nature of the distribution that we picked and because of the merchants that we're serving, which tend to be tail merchants, these are much smaller merchants, we've been able to sustain differentiated merchant discount rates.

So we feel good about our ability to do that in the past. We feel very good about our ability to do that in the future. And that's because our product is different and does something that is really important to these merchants. The other thing, just for what it's worth, the unit economics that we've talked about the 4.7% actually gives us quite a bit of room to be thoughtful around investing in key merchant relationships.

I think in the current macroeconomic environment, that's not really a topic for discussion on many people's minds. But if you think about competition continuing to be pretty intense, we feel like we have, if anything, the ability to be thoughtful about where we invest that. Honestly, the coverage right now is more about how and when merchant fees are going to end up going up in light of the current macroeconomic environment. So, we feel very good about it and feel good about this in any environment. Maybe one last final point. We actually have a real-life example of the value of our product, which was what happened in the early days of COVID.

Because I think there's a question behind Nathan's question, which is are you going to end up really hurting merchants when they need cash flow the most? And what's interesting, we lived this during COVID is the opposite was true. Merchants' willingness to pay goes up when they need cash flow because of the nature of the incrementality of the transactions we drive. That's not a piece of leverage that we particularly like to use but we know that our product is extremely valuable and merchants will pay us more in times when they're stressed.

Robert Henry Wildhack
Autonomous Research LLP

Got it. Let's talk a little bit more about some of your key merchants and start with Amazon. If you could just start by level setting for us how that partnership is progressing? And then I also want to ask, with 7, 8 more months of exclusivity, how should we think about your expanding that relationship in terms of products against that timeline for when your partnership or your exclusivity, I mean, ends in -- what was that? February?

Michael A. Linford
Chief Financial Officer

Yes, it ends at the end of the holiday season next year. I think let me step back a second, though. The relationship with Amazon is really quite strong. We have a partner who's invested in our growth and will benefit from our growth. Who knows that we're delivering a differentiated consumer experience and really values it and has come to the table with us and truly been good partners around how can we grow your business, how can we grow what we're doing here for consumers.

So they're aligned with us, and they're working great right alongside us. The product that we launched with Amazon and the weeks leading up to Black Friday was our interest-bearing product. That product puts most of the economics onto the consumer. And that is, indeed, something that we will continue to scale at Amazon and are happy to do so.

We maintain a very high level of customer satisfaction for consumers on Amazon.com, and that's an important thing for us. But it's also, as you alluded to, it's just kind of the surface. And so you've begun to see us experiment and roll out 0% offers, both those that are funded by us and by manufacturers out of the program. And you're going to see us continue to roll out those additional products, but not because we're up against some clock on exclusivity.

I do appreciate the question, but I think it's a bit misplaced because if we're relying on exclusivity for us to deliver results, we're probably going to lose in the end. And our mindset and mantra is to go fast because there's lots of consumers' lives who we can impact and lots of benefit we can deliver to Amazon, much less so because we feel like there's a clock out there at the end of which all sorts of things are going to happen.

And this has been the case for really all of our relationships. Last month, we also announced that we extended our Shopify relationship for another 3 years and that was well ahead of the actual expiration of the agreement we have with Shopify. And again, I think a lot of folks were incredulous as to "how did that happen?"

I think a lot of folks just don't like the truth, which is our relationship with these partners are really good and we do something that's different. It's good for the consumers involved and good for the merchants. And as a result, these folks come back to us and want to extend and keep investing and scaling those partnerships. So we feel really good about it. We don't feel like we're up against the clock in particular.

We feel like our opportunity is right in front of us, and we're going to pursue it pretty vigorously. I would encourage everybody to keep checking in on the offers they could see on Amazon, especially through the summer where we have a lot of -- a lot of awesome work going on with Amazon.

Robert Henry Wildhack
Autonomous Research LLP

Yes. And did you say that those 0% offers are live today?

Michael A. Linford
Chief Financial Officer

There are 0% offers live today on Amazon.com. I'd be careful, don't run as Max likes to say, put your spreadsheet down for a second. This is not something that we feel like it's ready to scale yet into being something that's very large. But what we're doing is learning. The opportunity at Amazon is so large, given just the breadth of products that they help sell as well as the number of consumers who touch it.

And so we're very interested to learn what works and what works for the consumer, what works for the category managers, what works for the brands who sell on Amazon. And right now, we're in that learning mode. But I'd like to remind people that we are not even a year into the launch of Shopify and we're certainly a lot less of the year into the launch of Amazon. So we're in the very, very early innings.

And so the opportunity, as we see it, is just very large in scaling these couple of marquee tenants. In addition to scaling our longer-lived partners like Walmart, who continue to have real growthful businesses that we can do great things with. And again, I think the success, whether it's the Shopify program or the Amazon program or Walmart program really relates to just how different we are and how we go about things in a different way that honestly, I don't think any of our competitors, or really any other company out there can replicate.

Robert Henry Wildhack
Autonomous Research LLP

Yes. And you've commented a bit on the economics of Shop Pay, Shop Pay installments. I'm wondering how the economics will look on the additional longer-term products that you're in the process of rolling out with Shopify?

Michael A. Linford
Chief Financial Officer

Yes. We really do like our unit economics, so we talk about them a lot. And we think that a lot of folks mistake that to be a measure of our view of, I don't know, profit or something like that. But for us, it's a risk management thing. It's like we need to have strong unit economics that allow us to navigate these uncertain times.

And that is definitely the case for our longer-term program at Shopify as well. The one benefit that we have at approaching the conversations with Shopify in these expanded deals is they really do care about us as a partner, they're shareholders of the business and they want us to be successful.

We're able to find a true, mutually beneficial agreement where we can make the unit economics that we need to make to sustainably deliver and grow strong unit economics, as well as something that allows them to grow their business.

The truth is, when you're working on these products that have a substantially higher merchant discount rate than just traditional credit card interchange. The pie is bigger, and we're able to create, we think, really good economics for all involved, while delivering compelling merchant experiences and impact to the merchant businesses and, of course, protecting the consumer from toxic financial products.

Robert Henry Wildhack
Autonomous Research LLP

Understood. Our next question comes from a retail investor who asks: "the Debit+ card quite possibly could generate larger popularity than Affirm as it's used through online retailers. How do you plan to ensure that it gains substantial adoption? Are there any plans to add rewards to Affirm debit+ or Affirm payments to incentivize consumers and eliminate any reason for a consumer to use a credit card over Affirm?"

Michael A. Linford
Chief Financial Officer

I love the question because I agree. I think the best piece of mid- to long-term upside could very well be the Debit+ card and what it could mean for people's lives. Today, our product works online and offline, but mostly online, and we deliver these really great experiences that are low friction, very quick and instantaneous approvals that drive outsized results for the merchants in the e-comm context.

And we're okay offline. We have solutions that work, and it's not an immaterial part of our business, but it doesn't have the magic that the online experience has. If you think about it, 70%+ of commerce is still being conducted offline. And the reality is until the industry, until Affirm figures out a way to create a really great offline experience, we're not going to move the needle there. We have plenty of growth to do online too.

But in the offline context, this is just such a huge opportunity for us. And we really think about it today as the best way to repeat on Affirm. So, we're going to think about rolling out the product carefully and thoughtfully, extending the card to our best repeat users. What that means is these are folks who know Affirm, they know our value proposition, and we know them. We know the kind of risk that we're taking with that consumer and we're going to start there.

And that may not mean we'll post gaudy stats on the number of users in the first couple of quarters as we launch the card, but it will mean that we'll be very careful. For better or worse, that's how Affirm runs as a business. We are very careful and thoughtful about the risk that we take. We're going to the same thing here.

Now that being said, I can't think of a bigger upside here as we get cards into the hands of millions of users. The data that we have today suggests that this card starts to work its way to be top of wallet for many of our users. And when we say that, what that means is this becomes the preferred way for them to pay, whether that's a cup of coffee or the groceries or even larger considered purchases.

And the reason for that is we've removed the decision point that a consumer oftentimes has to go through around picking a payment tender tied to the financial product. I'd like to include a brief anecdote, if you allow it where I was talking to a consumer who was trying to buy his son a bike.

And for those of you who tried to buy a bike for a child in the past really 12, 18 months, it's been hard, inventory is really tight, inflation is hitting bike manufacturers like it is everybody else, where prices have gotten up. This consumer told me that they were just going to "use their credit card to buy the bike and pay for it over time."

As you can imagine, this is a consumer I actually know, it offended me to my core, and I quickly explain to them that you're making a big mistake, your son can get the bike and you don't have to actually fall into that bad financial product. But that kind of motion or decision calculus that consumer was using is very common. I use my debit card for things that I pay for now, and I pull out a different piece of plastic, and that's the thing that extends my purchasing power and allows me to afford things that don't fit into my monthly cash flow. We're trying to bust that up.

Max calls it the unbundling of the credit card. I think what we're really about is telling the consumer just take the debit card and credit card and put them both in a different part of your wallet and just pull out your Debit+ card, and use that instead. And we extend to you the ability to pay for things over time for your larger consumer purchases. And for your normal everyday spend, we can settle with your bank. And there's no float, there's no need for you to borrow for that. You borrow for the things you need to think about in a bigger sense.

This sort of like deconstruction of the credit-debit system is something that we're really excited to get in the hands of a lot of consumers. And for the consumers who are using today, we see many of them beginning to show this kind of behavior. Max has talked about the frequency of use being really high, and that's a really good indicator that this card is becoming top of wallet. And so, we have a lot of excitement around that opportunity.

It's very early, and you're going to see us be very thoughtful about the kinds of risks that we take. But I think about upside here at Affirm in the next 3 to 5 years, this is easily one of the things that all of us on the management team are most excited about, and I certainly am an active user. And I can't wait to talk to everybody who's got their Affirm card. I still haven't seen one in the wild yet. One of my favorite things to do is to really look at and study consumer behavior and you'll see folks using their bank debit card at grocery stores I can't wait for the day I see them pull out the Affirm debit card.

I think it's on the horizon real soon and can't wait. With respect to additional features on the card, the questions are things like cash back and other rewards, it's too early for us to be declarative. I would just leave you with, it's definitely our goal to make this card, your best piece of plastic and the 1 card you pull out, and we can bring all sorts of really compelling value to the consumer when they do that.

Robert Henry Wildhack
Autonomous Research LLP

Got it. I'd like to switch over to the funding side of the business. Can you just start off by walking us through your different funding sources. And maybe more importantly, how you're thinking about each today given higher interest rates, wider spreads, everything that we're seeing in the market right now.

Michael A. Linford
Chief Financial Officer

Yes, it's a really good and timely question. And I think this past couple of days of macroeconomic news and volatility is just another data point in the fact that this is a very challenging time in that market. And we don't expect that to abate in the near term. I think the challenges ahead for the economy are real, and they've talked about and written about in a much more intelligent ways than I can in other places, but we're very aware and mindful of that. And we've thought about building our capital program to not be reliant on any one channel, any one partner, any one kind of partner.

And what you've seen us do is really try to diversify the types of counterparties, the types of funding models in our business, and you're going to keep seeing us do that. We've added a lot of capacity over this past year. We announced or discussed on our earnings call in May that at the time, I think we had $10.1 billion in funding capacity.

And what's important to think about is that amount of funding capacity funds at least twice as much GMV in our business because of the duration of our asset is really short. And so $10 billion might fund $20 billion in GMV or $25 billion depending upon the asset mix and I'm speaking intentionally round numbers here.

But our approach in how we built the funding program is to create that durability and scalability. It's never been about trying to optimize the last penny. And as a result, you see us show up with the body language of just like shrugging off a lot of this market. I think even in calendar Q1, our fiscal Q3, you saw hyperinflation, you saw the Fed beginning to act, and we posted some of our best unit economics with real leverage on our funding cost line. And that is counterintuitive to most folks until you really understand how the business is funded.

So we fund the business with 3 main channels today. We have our on balance sheet, warehouse financing. These are relatively low utilization facilities, but they're also pretty expensive. And that is the 1 piece of our funding that really does have true floating rate exposure.

And therefore, we don't really rely on it to fund the business for loans through maturity. It's there as we call a shock absorber. As the market hits any pothole in the road, we don't have to feel the bump, but also as a way to just manage the cash flow of the business to make sure we can put assets there until we can fund them into 1 of the other 2 vehicles, which happens a few times a week.

And the other 2 vehicles are our securitization program, where we're very active issuers in the ABS securitization world. And in our forward flow side, where we have counterparties who commit to buying whole loans. All of those funding models are committed capital. And we don't have a lot of acute expirations of that commitment. So we just onboarded a new capital partner in May. We announced it on the call, which was about $0.5 billion in capacity from a Midwest insurance company.

And I won't speak to that deal specifically, but let me just talk about the kinds of deals that we do with forward flow partners as a way to shed some light on why we don't have the same short-term rate exposure that I think people think we do. We generally think about, call it, 18 or 24 months in duration for these forward flow facilities.

And so the capital we onboarded in May; may fund us all the way through May 2024, which creates a lot of runway. And so we go off and we negotiate with counterparties, these pools of commitments and capital. And then when we're making an origination decision, we know where that asset is going to go.

That is a fundamentally different business model than some other nonbank lenders who originate assets and then attempt to place them and then are forced to put them on their balance sheet, for example. That's not how we like to run the business. We have to make sure we have pools of capital that we've worked with to create and then go originate assets to and place them into those pools.

My capital team, who's the best in the industry, they are out creating new pools of capital for us all the time. And our securitization activity is actually very similar to that. We have 2 types of securitizations the bulk of which the bigger part of which are revolving securitizations. And those function very similar to how that forward flow commitment works in the sense that you create 18 or 24 months of capacity.

And when you're making originations, you know there's a home for them. It's kind of fixed or committed capital. And the pricing on those deals tends to be fixed, too. There's a few of our deals that have episodic pricing renewals. Some as frequently as months, some twice a year and some have no pricing renewals at all.

But as a result, there's not a lot of short-term rate exposure to the business. We have a lot of certainty in the next 6 to 12 months on where things would be. That gives us the ability to be very confident in originating assets into these funding models with really a pretty high degree of confidence on how those will cost, which is part of the reason we posted such strong leverage on funding cost last quarter is you're really seeing a funding liabilities mix that was built over the past 18 months. It wasn't built in the quarter. We just don't build the capacity we need in the quarter, we're building for the future at all times.

And so as a result, there's a lot less short-term exposure despite the fact that the market coming back to it is quite volatile. And as you can tell, we've thought about this a lot, and we're trying to build a program that allows us to navigate in these pretty uncertain times and still grow the business. The linchpin to all of that, the reason why this works is because we're very careful on protecting the profit in the loan. We call that our unit economics.

That is the amount of margin in loan or profit in loan or whatever you want to call it. That's how much economic value there is every time we help a loan get originated on our platform. If that remains high, our ability to monetize that asset is, we think, never going to be in doubt. And if that ever deteriorates forever originating loans that don't have an economic content, don't have that yield or margin in it, we would find ourselves not being able to fund the business.

And so because of that, you see us not mess around with that. We're very thoughtful about the economic content in our loans. We're very careful on credit, which we control. And as a result, we will protect that even at the cost of potentially having to say no to a consumer who we love or having to say no to a merchant deal that can't be profitable. And that behavior, that mindset of protect our unit economics in order to ensure we have funding capacity for the business stands apart from any of our competitors.

We are more focused on the long-running, creating durable and scalable capital programs and a durable business than anybody else. And I think that is going to serve us very well over the next 18 months as the economic conditions continue to be quite choppy.

Robert Henry Wildhack
Autonomous Research LLP

Yes. I want to dive in there a little bit more. Between the ABS channel and the forward flow partners, I'm wondering how you -- or maybe you could go into more detail on how you decide who gets what and when. As you look at the ABS market could have volatile spreads or risk-free rates are moving up and down. So the pricing there is changing.

Whole loan investors could be responding to different outlooks for credit risk, for example. So their expected returns might be changing. So how do you balance all of that with managing your funding costs and keeping your funding partners happy.

Michael A. Linford
Chief Financial Officer

Yes. So again, I think the short-term duration of our asset and the long-term nature of our funding commitments allows us levers that really aren't at play for many other players. And therefore, we don't have to make some other really hard decisions that I think some folks might have to make around Do I do this deal or not, do I fund the business or not next quarter. We don't find ourselves confronting that decision.

Everything we do is a lot longer term in nature. And that allows us to be thoughtful and strategic about it. And so what that means is we need to add capacity to the business for the long run, it means that there is a price at which we don't want to transact. It also means that we can absorb spikes or slight increases for a small part of how we fund the business.

We did the revolving securitization deal in May at costs that were higher than the deal that it was replacing. That's okay because it was an important part of how we run the business, but by no means it was going to dictate the total funding cost for the business because we have so many diverse and existing funding sources.

It just mixes into the total portfolio of funding that we have in a way that creates a slight tick up or a slight tick down in our business. We don't really like to think about the funding model as being specific to the kinds of origination decisions that we're making.

And that has a lot to do with the kind of underwriting that we ask folks to do. I really think our capital partners spend as much time thinking about Affirm as they do about a specific asset. So they see millions of transactions. They can't be thinking about trying to cherry pick 1 particular asset, most of our investors want full exposure to the entire portfolio that we're creating because that's the risk decision they've taken to really back us and want the full exposure.

There's a couple of exceptions to that tends to be in long or short durations. Our super long duration assets need a specific home because it's a very different capital allocation, the decision that an investor might need to make. And our super short duration assets don't find themselves being sold as much. They tend to be more just held all the way through maturity on our balance sheet. So with those 2 exceptions, notwithstanding, most of our allocation decisions are seeking to get something that is approximate to kind of a full explosion to most of our counterparties meaning that they want the full Affirm exposure.

There's caveats I need to put out there. We have certain concentration limits that we manage around and we're careful around certain on the margin concerns from investors or asked from investors to predict their capital profile. But those are really on the margin. The thrust of it is if you're a forward-flow buyer or you're buying our securitization, you're really looking at getting a very similar mix of credit performance with those pieces that I discussed being taken out first.

And as a result, we find ourselves again talking a lot about the quality of the asset we generate generating a good asset, there's going to be a good funding partner, and we don't let ourselves be reliant on 1 partner for the good assets and 1 partner for the bad assets. We think that's really not a strategy that serves you well. If your goal is to create a very scalable and durable capital program because then you create pockets of risk that we don't really like to take on.

I think there's not really any insight you can get into how we think about the allocation decision. Much more important is the diversity of the partners and bringing on board enough capital and scale.

Robert Henry Wildhack
Autonomous Research LLP

Okay. Got it. About a little less than 10 minutes left now. Let's make sure to touch on credit, and there's a lot of focus on how Affirm might perform in a credit downturn or a deteriorating credit environment. And I'm sure that a lot of people here are familiar with credit cards or other payment products, how they perform. For some reasons, that's a reasonable context in which to put Affirm. For a lot of other reasons, though, you're very different from credit cards and other payment products.

So talk about those differences and what that means for losses at Affirm in the context of an adverse credit cycle.

Michael A. Linford
Chief Financial Officer

Yes. I think the comparison -- I understand why investors want to look at the comparison to credit cards because it is unsecured consumer credit. But I think the similarities stop there. And I think folks are going to see how this plays out through the cycle.

If I could leave you with just like 1 really specific reason why they're different is an open line of credit to a consumer versus a transaction level approval are just very different. And the weighted average life of a credit card balance is on the order of years, the weighted average life of an Affirm asset, it's 5 months today. And when you have that super short duration, you don't confront a back book problem.

And so in the lending world, you talk about a back book and front book. And so you're going into a cycle with a certain amount of originations already having happened and you have a back book, and you have to manage that back book. So your credit decisions you took 2 years ago are affecting your credit outcomes in a meaningful way.

At Affirm, the credit decisions we take today are what matters. We see the rising uncertainty. We see the tilting towards what the market estimates will be a recession that may result in higher unemployment. And as those things start to play out, the decisions that matter aren't the decisions that we took last year, the decisions that will matter are the decisions that we take now and over the next 6 months.

And our credit modeling is really good. And so we're able to sort risk, and we believe we'll be able to do that in any macro environment. So as we sort our risk, we can continue to be thoughtful around what happens to the lowest credit quality consumer through a cycle and be mindful about risk as we extend them.

But because we were only really out 5 months on a weighted average life basis, we don't have to pull the brakes as quickly. And we know the DQ measures are all just not quite as comparable as you see in our business. You'll hear this answer a lot. I really think one of the best ways to view our credit outcomes is to look at our margins.

And it's counterintuitive. But at the end of the day, we can make money with a wide range of different credit outcomes. We've talked about this a lot on every earnings call, I think since we've gone public, for the first 5 of them, I said we've been intentionally looser on credit, we had been.

And as you saw that delinquencies were rising. I think that we deserve a little bit of credit for having been very clear on this since day 1. And you've seen them begin to plateau because we do think that the credit outcomes you're seeing today are the credit outcomes that we probably feel good about right now. If we felt like the macro environment was beginning to deteriorate for the measures that matter on our repayment like unemployment, you'd see us take a different credit posture.

But for where we sit today, we're seeing credit outcomes that are in line with where we want them to be. And the best read-through isn't looking at a DQ chart, although we give you those disclosures. It's not trying to do I think some really dangerously inaccurate math on charge-offs because the nature of our asset is so short, you miss a little bit of the actual credit cost in the business when you do that.

I think the best way to look at it is, can we produce really good unit economics. And the reason why that works is because we treat our allowance -- our provision for credit losses really seriously. And so we maintain a really strong allowance and as credit deteriorates, you'll see that allowance go up on a percentage basis. And if credit doesn't deteriorate, that number gets to be pretty flat.

And if we can still generate enough revenue and margin despite that high level of allowance, then we're doing what we should be doing, and we're "robust" through the cycle. I really think that's the best way to look at it. I know I'm alone in that. I don't think everybody believes me yet. I think when we get through the cycle, folks will look back and have a better understanding there.

The credit cards can't do something similar because they have future expected losses that don't -- that cannot be reflected in current balances given the fact that people have open lines that they can go tap. And that's just a thing that we stand apart on.

Robert Henry Wildhack
Autonomous Research LLP

Got it. All right. Last two more questions to fire through. You finished the March quarter with almost $3 billion in unrestricted cash and securities. What's the plan for all of that? And I can tie that to a retail question, Philip R. asks, as it appears the company is undervalued by the market, would you initiate a stock buyback if those conditions persist?

Michael A. Linford
Chief Financial Officer

At some point, we might. Right now, we think a better use of our capital is growing our business. I said before in another context, and I'll say here now, we think we're really well capitalized.

And you asked the cash flow question, I gave you kind of a dodge of an answer. The point is we don't need our $3 billion of dry powder to get to profitability and cash flow, which means we can do something with that. One option is we could do share buybacks. I think even with our depressed valuation, which none of us are happy about, we think that's less viable than using that capital to grow the business where we think there will continue to be really exciting M&A opportunities.

I would say that a boilerplate statement that we actually treat very seriously is that we will always do the right thing for the shareholder. And so if you see us do a share buyback, it's because we think that's the best thing for the shareholder. If you see us go do M&A, that's because we have conviction that it can add more value and build a more valuable business than any share buyback.

And I think that's how you should read our actions as we're thinking about how we create long-term shareholder value. And the whole management team, me and Max and all of our executives are very aligned on creating long-term shareholder value. I think that puts something like a stock buyback at something that is not the top of our list to do in the near term.

But I think we've learned anything in the past year, it's that things change really quickly. And so it's a question -- it's a really fair question. But today, as we sit here, we feel better about deploying capital against scaling our network because the real value of our business is not where it currently trades today, which we all don't like, it's where we're going to be in 5 years. I spent a lot of time talking to my team about this. We look back and study prior major economic dislocations like 2008 and 2001 and the various resets and valuations that have happened. They take years to get right.

But when they do, the businesses that invested in building delightful consumer and merchant experiences, the businesses that protect their unit economics and have robust funding positions like we do are the name brands that you all know today and you can create really long-lived companies, and we're excited to go do that in the next 5 years.

Robert Henry Wildhack
Autonomous Research LLP

All right. The last question for me, and I can also tie this one to a comment or a question from the audience here. But you alluded to it, to say a perfect segue way. What does Affirm look like in 5 years? And what are the guideposts along the way that we should be tracking on your progress to the vision.

I'll add Michelle C's question, which is what are the future goals and plans of this company. I want to buy more stock, however, my confidence in the longevity of the company, it's kind of cut off here. But yes, I think you understand the gist there.

Michael A. Linford
Chief Financial Officer

Yes. And Michelle, I'll tell you, we have a lot of confidence inside the team, about we're going to be in 5 years. I think the guidepost and markers are all around really 3 pieces.

Can we create a lot of scale? Are we going to be big? And I think the past 1.5 years has shown us put down really strong markers on our enterprise relationships. 60% of U.S. e-commerce is now integrated with Affirm. We think this is a category that still has a ton of market growth, as we said before. So we have a lot of confidence that we're going to be very big and tap into what we think is a trillion-plus dollar opportunity in terms of market size - we're going to be big.

And then the second question is, can we print strong unit economics. You heard me say that we're 14x today, I bet and you'll hear me say 100x tomorrow. We protect our unit economics, and we have a lot of confidence on it.

We don't think it's going to be north of 4% in long run, we do think it's going to be 3% to 4%. And our ability to do that at scale creates a really valuable franchise.

And the third question is, can we show operating leverage I think the thing you heard us commit to last May is we're going to show real operating leverage in our next fiscal year, and we're going to exit to where all of our funding of the business will come out of the margin in the business.

What that means is we can continue to be really aggressive about growth and deploying our capital towards building that massive opportunity ahead.

I'd encourage investors to hold us accountable to being bigger, to printing strong unit economics and showing operating leverage over time.

Robert Henry Wildhack
Autonomous Research LLP

All right, Michael, that's a great answer, and that puts a wrap on our session here. So thank you very much for your time to our audience. I hope you all enjoyed it and were able to learn a lot. Thanks for attending.

Michael A. Linford
Chief Financial Officer

Thanks, everybody.