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Affirm Holdings, Inc. (AFRM)

Investor Meeting - Fireside chat

CORPORATE PARTICIPANTS

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

OTHER PARTICIPANTS

Jason Kupferberg
Analyst, BofA Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Jason Kupferberg
Analyst, BofA Securities, Inc.

Hi, everyone. I'm Jason Kupferberg, the Payments, Processors & IT Services Analyst at Bank of America and we're very excited to have with us today the CFO of Affirm, Michael Linford. Affirm has been doing these calls over the last few quarters to give investors an additional forum to have access to management, ask questions, et cetera. So, Michael's going to make some opening remarks and then we've collected a bunch of questions from the investment community, which I will be bobbing into Michael in a fireside chat format and really looking forward to the dialogue. So, Michael, thank you for being with us here today.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

Thanks, Jason. And I'm really glad to be here with you. And I'm glad for all the investors who are joining us today. Whether you own one share of our stock or a million, we thank you for your support. Along with the rest of the 2,500-strong Affirmers, we're extremely focused on rewarding that support by building a highly compelling network and driving long-term shareholder value.

Our objective is straightforward. We empower consumers with honest financial products and help merchants drive growth. We aim to do this by leveraging our superior technology, risk management, and capital markets expertise. These three moats, as well as our fundamental alignment with the consumers, given our practice of not charging late fees or hidden fees of any kind, have enabled Affirm to become a partner of choice in the category. We're excited about what we have to offer consumers and merchants and our investors. And we look forward to answering your questions today and continuing to engage a two-way dialogue and pleased to be working with Say Technologies to do that. So, with that, Jason, let's get started.

QUESTION AND ANSWER SECTION

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

Let's do it. Plenty of questions, lots of content to get through here. And one topic we wanted to start with, maybe to piggyback on your opening remarks, is that the BNPL industry, we think, is clearly becoming more mainstream, but more and more evidence of who the longer-term winners in this sector may be. We think that there's, frankly, too many competitors chasing the BNPL market. And would just love to get your reaction to that. What's your assessment of the competitive landscape?

We have a related question from a, investor, Mario L., who was asking specifically, how will you differentiate yourself from other buy-now-pay-later companies?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Thanks for the question. And we feel like we are already differentiated and that differentiation is really coming to light right now, especially in this current environment. Our focus is on supporting merchants to deliver the best experiences to their consumers and empower those consumers to live better financial lives. The space is massively underpenetrated in the United States. We're still very much in the early innings of BNPL adoption across the whole industry where we estimate we're still low-single-digit penetration as a percentage of US e-commerce.

And so, the space will be competitive. We're confident on that for years ahead, but we do like our position. We've focused on underwriting and risk management out the gate. We – initially, our business started with the higher ticket purchases. These are more considered purchases where data and risk management and underwriting really matter. And throughout that learning and early in our company's life, we've really built an advantage with that data and the technology that we've had to build in order to apply it to the underwriting problem.

And we started with that hardening on purpose because that's the hardest thing for others to replicate. If you think about the space, some of our competitors are really good at doing the split. We call it Split Pay, pay in four. And we've really built a whole suite of solutions, and that allows us to be differentiated for those merchants. We can mean more to more transaction types. Of course, we're still very much broadening our portfolio. We seek to mean something to every transaction, and that advantage we have in risk management underwriting we think sets us apart. And it's the reason why we've been picked by so many large enterprises. If you think about the wins that we've had with Walmart and Shopify and merchant partners like Walmart and Amazon, these wins reflect the fact that we are the partner of choice.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

For sure. For sure. Yeah. No, we can certainly see that in the numbers based on how fast Affirm is growing payment volume versus some of the other competitors out there who are disclosing their data. Let's move over to the US consumer, obviously top of mind in every conversation these days, lots of debate and controversy around the health of the consumer, particularly if we think about the lower to middle income cohorts and particularly around more discretionary types of spending. So, what's Affirm's take on this topic? To what extent are you observing softness in certain pockets of your customer base? Think you talked about this a little bit about a month ago on your earnings call. And then I guess, more importantly, how does that then influence how you run the business, just given that there is a lot of macro uncertainty for all companies to cope with right now?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. So, as we shared on the call, we are beginning to see the signs of stress for a certain subset of our consumers. And it's really important that investors hear that as us acknowledging the stress those consumers are feeling, more so than the impact it has on us. Because as we've said all along, it's our job to manage that. And we certainly can't control the macro conditions. But it's clear to us that consumers aren't teeing off of the Fed's comments, they're just living their lives.

And if you think about the things that impact us and our consumers, by far the most important is employment. And the good news about the US consumers, we still have really strong employment. And that means that folks have jobs and they have income. But the stress is manifesting itself due to the higher cost of living and inflation that you're seeing across a wide set of categories. And in those environments, we think our product means more. We think it's more important to be able to offer consumers financial flexibility.

And yet, the balance with that is, obviously, when that consumer begins to show signs of stress, we begin to have to be more careful on how we think about problems like the underwriting challenge. So, we're being very careful and thoughtful about how we underwrite in this market, although we do think that our product means more to consumers and the consumer is fully employed which is a really good fact in our favor in terms of how we think about the consumer going forward.

Clearly, you also have a slowdown in US e-commerce. During COVID, you saw that big surge up and we've normalized to kind of pre-COVID trends and that creates a little bit of noise in the numbers in the near-term. But the fundamentals underneath it remain very similar to when we started this company a decade ago. The consumers are adopting new ways to pay and doing so in very big numbers. And that acceleration we saw during COVID isn't turning around and the value of our product is on full display right now.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

Yeah. Right. And you're still calling for 32% to 42% GMV growth in a pretty tough macro backdrop. So, that should count for something. I wanted to just maybe switch gears to kind of a higher level question. I mean, the business model of Affirm obviously has a lot of layers of complexity to it. And you've touched on some of them at a high level so far. So, maybe just zooming out for investors who are kind of newer to the story, trying to get up to speed, what are really the most salient attributes of the business model that these investors need to understand? Because there's just kind of this ongoing debate, is it a tech company, is it a financial services company, is it both, right? And you can maybe help us unpack that and simplify it a little.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. We think it's a whole new thing, which is why I think folks do struggle with it. I think any conversation about our business model has to start with what is the reason for our ability to have built this business? And that is at its very core, consumers are walking away from traditional credit products. And you've seen over the past several decades an increase in adoption in payment methods like debit cards, which are great because they don't have any of the potential harms associated with revolving credit cards, but they deprive the consumer of purchasing power.

And businesses like ours were created to address this problem. We want to give consumers a safe, healthy financial product that gives them spending power without the pitfalls associated with revolving credit products. And that core backdrop is the reason why we exist. There's no amount of technology innovation and no amount of risk management that could force the consumers to change their mindset. They've been waiting for someone to come along with this product in the past couple of years, and the explosive growth the category has shown really reflect that underlying consumer demand.

So, we have consumers demanding new ways to pay and then you have us trying to meet that demand. The way we meet that demand is, again, first and foremost, by focusing on our strengths. We are really good at underwriting, we're really good at risk management. We apply technology and data science to that problem. And we have a culture in how we operate the business in terms of managing risk in a really detailed fashion.

We have the widest set of products. So, today we can finance small tickets, we call them average order value, low AOVs, all the way up to very high AOVs, short-term in duration as short as six-week and as long as 48 months. And that breadth of products, that mix of products and flexibility we have, gives us so many levers to grow our merchants' businesses while still giving consumers really delightful experiences. And all that's possible because we have a very strong technology orientation at our core. And so, we take those – all those challenges and that consumer demand, and we meet it by building world-class technology products that grow merchants' businesses and give consumers a really healthy way to get that purchasing power that they need.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

Let me ask you a follow-up question, just kind of on the macro environment and the extension of that is we are seeing some signs of delinquency rates for various credit products creep back up. I mean, in many cases, still kind of in the normalization phase, if you will, and perhaps below pre-pandemic levels, but nonetheless going up. Affirm certainly sounded quite comfortable, I would say, with the risk profile of its loan profile – of its loan portfolio on the latest earnings call. So, maybe just help us reconcile some of those because it feels like credit trends are going the wrong way but Affirm seems pretty confident. And maybe you can just go into more detail there for us.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. I think one of the things we like to talk about is stress on the consumer, while it's very evident right now, isn't something that intimidates us. It's actually part of how we built the business model. We always talk about underwriting through the cycle. And so, we're very mindful of what happens to the portfolio when consumers do begin to experience stress. And how we react to it really determines our ability to manage it.

And so, I think the things that position us very well in this environment are the relatively short nature of our assets that we generate. So, when we say that, we mean the duration of loans, the term lengths of loans is very, very short. So every day, we're out approving and evaluating transactions. And over the course of a quarter, we might look at 20 million transactions and make approval or decline decisions. And those transactions that we approve or decline, today have an average life, weighted average life, it's a bond math term, but the way I think about it is that the life of a dollar lives through about five months. And so, the credit decisions and outcomes you're seeing today are a function of the decisions largely that have been made over the past five months. A lot of people who approach lending problems are sitting at durations of a year and a half or two years. And so, the problems they're seeing today reflect decisions that were made a long time ago.

And so, we talk a lot about how reactive we are. We're very good at predicting credit outcomes, with machine learning and data science. We're very good at that. But we're also very good at reacting. And the short duration of our asset allows us to see stress and then manage it. And we have a whole bunch of tools to manage it. It's not a simple say yes or no to the consumer. We can change term lengths and down payment mixtures, and we can offer different products in different situations. And stuff that our competitors can't do because they're typically mono-line, one-product players. And we have a whole suite of products that we can bring to bear. So, we always talk about it as, as stress happens, then we can manage through it because we have a wide set of tools and we have an inherent advantage in the short-duration asset that we generate.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

We have a question from a retail investor Jorge R., who wants to know how Affirm's path to profitability will be impacted by rising interest rates alongside high inflation.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. I think, again, it's really important to remember that we believe our product is more valuable in these environments. It is the case that higher rates increase our costs, that they either increase our cost of funding or put pressure on the gain-on-sale lines in the P&L. And we've talked about that, frankly, going back to February in our Q2 last year earning call, we talked about how the rising rate environment would impact us, but it would flow through on a slower timeline than I think most folks have been thinking about.

The way we approach capital in the business is we go off and try to secure funding for loans before they're originated on our platform. And that gives us this advantage of we're originating into fairly certain cost and/or revenue profiles. And so, we're not quite as subject to the shocks. And make no mistake, the current rate environment, certainly since the beginning of this calendar year, has been one of a rapid increase. You saw the Fed move in the markets, expectations of rates continue to rise in a really quick basis.

And yet, our business model has built in some shock absorbers to that, where it doesn't flow through immediately. And that allows us to be pretty planful around how we make our investments. While we're going to be prudent with our investments, we're still going to be investing and have been for this fiscal year as we think there's a lot of opportunity ahead. We think we're well-positioned to manage the credit side of that, as I talked about before. And we have continued to repeat our commitment to get to profitability on an adjusted operating income basis by the end of this year, despite the rate environment being as volatile as it is.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

Right. Right. Yeah. No, I think that'll be an important milestone. And I know you intend to stay at sustained positive profitability once we get to Q4 of this current fiscal year. I wanted to circle back maybe on a couple of credit-related questions. One thing I think some investors are struggling with is a little bit of uncertainty around what's really the best way to measure and monitor Affirm's credit performance. I think perhaps there are some points of clarification you can offer there because it feels like there's a little confusion in the marketplace around which metrics have the most validity and which perhaps are not as valuable.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. So, first and foremost, we don't manage credit with really any other eye except towards our unit economics. And so, when we're making an underwriting decision, we're asking the question, can this transaction be profitable for us? And that means that we're evaluating the risk in line with the revenue and the costs in the business, and that's how we – that's the spirit of how we approach it. And yet, it's really difficult to translate that into the external measures. But it's important that when we talk about our revenue, less transaction costs. We talk about our unit economics. The goal of 3% to 4% in the long run is the thing that ultimately governs how much credit loss we can have in the product. And our ability to both predict that and then manage that outcome is where we talk about our risk management capabilities really being on display.

It's really important that folks, when looking at the pure credit measures, don't look at anything that's denominated by the principal balance outstanding. As I mentioned before, our asset has an extremely fast velocity to it. And so, it's the case that, the first quarter after the loans are originated, you might have half of the total balance paid off by the time you get there. And what that means is you're creating a bit of a goofy comparison when you denominate it by how much loans are outstanding, as opposed to how we look at it, which is of the volume that we originate, what's the margin content inside of it?

And so, when you start to denominate things as a percentage of GMV, you begin to get a lot more clarity around where the actual credit performance lies. And that's why we like our unit economics so much is we know where those charge-offs and those delinquencies sit as percentage of GMV. And we know how that's going to translate ultimately into what we can print for the shareholder in terms of our transaction economics.

Jason Kupferberg
Analyst, BofA Securities, Inc.
Q

So, I guess the takeaway there is focus on the output, which is the revenue less transaction expense as a percentage of GMV. The credit-related items that underpin that are just one of multiple inputs that ultimately drive the achievement of those unit economics.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.
A

Yeah, exactly. And I think folks who want to make comparisons of credit cards are making a kind of an intellectual mistake at the outset. Because for credit card companies, the future credit outcomes are a function of the originations that happened a year or two ago. And again, because of the velocity of our asset, the credit outcomes that we'll see in the back half of this year are decisions we'll make ahead of us, not behind us.

Jason Kupferberg
Analyst, BofA Securities, Inc.
Q

Right. That is an important distinguishing factor. The other thing is, I would say that's been coming up since the earnings call last month, some of the credit-related messaging on the call, some of the qualitative comments, for example, sounded like Affirm is, to some extent, tightening the credit box. And I think you give a couple of examples of that and maybe you can go a little deeper there. But then I think there were also comments made that approval rates have actually been increasing. So, at first glance, those might sound contradictory, but maybe you can reconcile that for us.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.
A

Yeah. It's one of the superpowers of Affirm, I think. We can find ways to still approve a transaction and minimize the credit exposure on that transaction. And this is like a truly novel thing. This is not a thing that I think anybody else really has the capability of doing. Because of that breadth in product mix and all the other leverage that we have, we can still get to an approval decision that tells the consumer that we can approve your transaction and we can take some risk off the table without just tightening the credit box.

We'll do that too, of course, but we will look at things like down payment rates and we'll tell the consumer that we're not sure you can handle $500 of exposure. And so, we're going to ask you to put $100 down and to minimize the exposure you have. We can change term lengths to manage our credit risk. And of course, we can do tightening and loosening as well. And the mixture of products and down payments and the credit lever itself allows us to just to have more options.

And additionally, our credit teams wake up every day asking themselves, how can we go find more positive selection in the credit applicant pool? And so, we're constantly working on that problem. Credit – the credit problem at Affirm is oftentimes talked about as like a treadmill, on that we're sprinting just to stay where we're at. But we're still sprinting and that means that we're finding ways in order to improve the overall credit outcomes, even while reducing – and maintaining, sorry, and maintaining the level of approval rates.

And so, saying yes to consumers is a really important thing. We need folks – our consumers to stay engaged in the platform. We need them to be here and to have the same love of Affirm as they have. The worst thing to tell a consumer is we're going to approve you and then have a bad credit outcome. The second worst thing is telling the consumer, we can't improve you at all. And so, so much of the work that we've done is to find ways to be able to say yes to the consumers.

And it really showed up in our last quarter's results. In our Q4 results, we've posted really strong unit economics. We've posted a ton of growth. And we mentioned on the call, we gave up a few points of growth. And what we mean by that is maybe our GMV growth could have been 1% or 2% higher, but that – it wasn't worth it, given the fact that we saw our consumer beginning to show signs of some stress. And that's the level of management that we're able to do. And so, these are very specific and scalpel-type approaches. We don't have blunt tools. We have very, very focused and specific tools that we use.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

I wanted to drill back down into the gross profit metric, again, the revenue less transaction expense. You talked about the 3% to 4% longer-term target and you've been very consistent in articulating that longer-term target really since the IPO in early 2021. So, maybe just go a little deeper. Why is this the most important operating metric? You've actually been doing better than 3% to 4%. How have you been able to exceed that? And is it feasible to continue that trend?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. We had been ahead of it. And I know you and I have talked about this quite a bit, but really the whole analyst community keeps encouraging us to say we're going to be above the number. And we keep telling the community that, no, we really mean it when we say 3% to 4%. That's a really healthy level of transaction economics. It's a really healthy level, especially when you consider the velocity of our asset in terms of the total returns we can drive. Why that's so important is you should think about Affirm as – the business, as we generate some assets, those have some economic content for us. That's at 3% to 4%. That's kind of our take in the whole pie, net of all of our transaction expenses.

And on the other side of the P&L, we have all the investments we make in engineering and product development to build new delightful products. When we talk about getting to profitability, it's really just balancing those two numbers to [ph] the parity (00:23:33). And so, it's really important that we're printing unit economics that have enough content in them. And it's also important that we don't make the mistake that maybe some of our competitors have made around convincing themselves that you should run on negative unit economics and make it up on volume. Of course, that doesn't actually work. And so, by printing really good units, we know that we can continue to confidently scale the total level of that economic content on our origination platform to help pay for all the investments that we want to make.

Our confidence in that range reflects the product mix that we have. There's any number of ways to break down our product mix, I think the easiest way is to think about our Split Pay product, which is super short in duration, and then the rest of our portfolio. And if you think about that, we kind of have a very high-velocity, but lower-margin product, think like 1% or 2% type margins. And then we have a still very short duration, but slower asset that can make as much as 5% or 6% unit economics. And the two blend into that 3% to 4% range over time.

And, yes, there are things that can impact it. Clearly, if we have higher rate environments, that's a headwind and we have to go manage that. And if we have higher credit losses, that's a headwind that we'd have to manage. But we have a lot of confidence in our tools to manage those increase in costs by either binding revenue or reducing those costs outright. And that gives us the confidence to continue to deliver that mix of margin in our platform.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

Let's switch gears to Amazon, obviously a very important customer. You're approaching the one-year anniversary of go-live with Amazon. Tell us, how has the partnership evolved here over the past year and what are the priorities for this current fiscal year with Amazon?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

It is kind of an interesting moment. We're not yet even to a year. We went live a week before, week and a half before Black Friday with Amazon last year. So, we still have all of October and most of November before we get to the one-year anniversary. And I don't remember who it was, I can't attribute it. But someone repeated the line to me that, oftentimes, people massively overestimate what you can get done in a year and underestimate what you can get done in a decade.

And it's true that we are very early in the relationship with Amazon, not even yet a year into it, and yet it's a really big important partner for us because it's a huge amount of US e-commerce. And it is important to us to continue to scale that relationship and really addresses much of that market as possible. And you're seeing that with various shoots of experimentation with alternative products that we're doing. You've seen changes in when and how you see the Affirm offer on the site. We kind of got out the gate and just barely got live last year. And this past 10 months of being live has been one of a lot of iteration.

But as maybe the best signal of the depth of the partnership here, you saw our recent announcement that we expanded our partnership into Canada, which is a really huge signal for us. That is us both saying this is working so we want to take it to other places. At least that's my read of it. And I can't think of a better signal around the health of that partnership. And so, we're confident. There's a lot of work to do. We have a lot of work to do in the US and a lot of work to do globally, as our Canada announcement demonstrates. And so, we're going to keep working on it.

And again, if you measure the success of these partnerships in the first year, I think you missed the point. To our experience, that these things can take many years before they get to the scale that you want to get to. And clearly, the size of the partner in Amazon means that a little bit of success is still very big. But that does not mean at all that we think we're limited in terms of the opportunity here.

Jason Kupferberg
Analyst, BofA Securities, Inc.
Q

And just remind us of the exclusivity element of that relationship and the potential for that to continue?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.
A

Yeah. So, for those of you who are Amazon consumers, you'll probably notice just how much is going on on an Amazon product display page or an Amazon checkout. There's a lot there. And so, we really think about us as having to earn anything that we get. And that's going to be the case, frankly, regardless. And we think that that the benefits that we drive to the consumer on the site is the most important thing, well more important than what a contract says, and that's where we're focused. We're focused on making sure that we create these really delightful experiences.

The thing that I'm personally most impressed with about our early partnership here is just how much of a common and shared focus on the consumer is across our two companies, where we are so concerned with doing right and creating value for the consumer. And by far, Amazon, in our experience, cares most about that more so than any other measure.

Jason Kupferberg
Analyst, BofA Securities, Inc.
Q

A related question from a retail investor, Donald J. Are there any plans for mass global expansion through any one of your large merchant partnerships, Amazon, Shopify, Stripe, et cetera?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.
A

So, I think, again, launching with Canada – in Canada with Amazon is a good signal for what we would [ph] like (00:29:18) to do. We're partnered with really big global enterprises, and one of the benefits that you get by that is geographic expansion becomes now a partner expansion as much as it does a truly net new thing. In the case of Canada, we actually were able to get there when we did because of an acquisition we made just before the IPO. And we've really built, post that acquisition, a strong market-leading position in Canada. And that reflected, I think, Amazon's choice to want to partner with us there.

And there's a lesson there. We have to earn it in every market we're in, there's no guarantee here. We had to hustle and bust our hides in order to get each new market with these partners. And yet the opportunity is huge, the opportunity is huge in the US, but obviously the players you mentioned are global in scale too. And we'd certainly like to be able to go global with them.

Jason Kupferberg
Analyst, BofA Securities, Inc.
Q

You've got all these huge merchant partners, you've been thought of as the [indiscernible] (30:20) partner of choice by a lot of the largest merchants in the world. So maybe just tell us, what does the pipeline look like at this point for other potential new merchants for Affirm to add? Are there other still really big ones out there that could be in the pipeline and any direction on what sort of verticals those might be potentially concentrated in?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Every time I'm checking out anywhere and I don't see the Affirm checkout option, all I could think about is all the opportunity we have. And there's truly a lot, there's a lot both within our existing partners. We like to talk about how we've got over 60% of US e-commerce partnered with Affirm, and that's good. We have a lot we can do to penetrate those. But there's, of course, the remaining portion of US e-commerce that we can continue to go partner with.

And then there's things like going offline where as an industry I don't think anybody has really solved that problem with great success and we're excited for what we can do there. Because if you think about the e-com trends, they're wonderful and highly [ph] growthful (31:29) and there's so much opportunity there, but the massive retail is still happening offline. And I think if we can bring our solutions to that context, there's obviously a ton of growth. And I think that's also reflective of some of the partners that we're with. Some partners have much higher focus on their brick and mortar and offline presence they do in their online and e-commerce presence. And I think that it's a real area of focus for us and real area upside as we continue to build products there.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

I'm going to move over to the product side of things. I know your CEO, Max, has sounded very excited about the new Debit+ product for a while now and it might be a good opportunity maybe for those less familiar. Just walk through some key features of the product, the value proposition for both consumers and merchants and then to kind of dovetail with your comments around the in-store opportunity. Is Debit+ part of that strategy?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. The last one first, absolutely. I think when we thought about the Debit+ product it was important to us that we were thinking about widening the kinds of transactions that you could use Affirm on. Traditionally and where we grew out was really larger considered purchases online. And we've done a great job in widening that to address the biweekly or paying for we call it split pay offering which shrinks the average order values that you can address down quite a bit. But it still doesn't address every day spend and it still doesn't really crack the offline [indiscernible] (33:05). And I think Debit+ is our solution to that.

The Debit+ product works by connecting to your bank account and gives you the flexibility and purchasing power of our pay over time options with the simplicity and safety of a debit card. So I've been using the card since we've been in early beta and it becomes my [ph] top of wild card (33:27). So every transaction I'm out, I'll use my Debit+ card, either the physical card or I have it in my Google Pay wallet and I'm able to buy my cup of coffee and that sweeps out of my bank account the following day. Or I can when I go to say a nice dinner or buy a bike at a bike store, I can get the purchasing power that I enjoy so much from the Affirm product for that specific transaction.

And the reason why this is so powerful is most consumers today have to think about using one card or the other. They either use their debit card to pay now or their credit card to revolve. And their credit card stays in the wallet except when they want to revolve and pay for things over time and their debit card is a primary use card. Or you've got consumers who are just transacting on their credit card and they're not taking advantage of the pay over time benefits because they know the minute you start revolving, every transaction becomes a revolving transaction. And the genius we think of the Debit+ product is we've kind of solved that conundrum and we've told the consumer, you can use this one product for all transactions and you can get the safety and the low cost of your debit transactions along with the flexibility and paying for things over time.

And then the best thing about it is the early data indicates that it is being used widely. The frequency is really high, the early testers in the product are using the products about three times a week and the mix of businesses is about half offline and half online which for us is really encouraging because it's breaking through that offline purchase modality that we really weren't able to get to today.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

The initial financial guidance you've given to the investment community for fiscal 2023 does not include any contribution for Debit+. Would you expect at some point during the fiscal year to actually incorporate Debit+ into your financial outlook?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

We would. I think we're really careful to not give any timeline so we've said that as soon as it becomes more material, we'll give you some estimates to think about it. That's especially true because as we talked about our unit economics number, we're going to need to arm investors with the way to reason about our volume when the Debit+ volume starts to flow through. But right now, it's not material and not to be included in the guidance.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

Right. Right. Okay. If we think back to about a year ago, you guys had an Analyst Day, talked about longer term strategy. And related to that, we do have a question from a retail investor, [ph] Melody M. (36:07), asking about Affirm's plans to offer other services outside of BNPL? Maybe you can talk about that part of your strategy.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. So we started with high average order value. We've now added lower average order value. And of course, we just got done talking about Debit+ and all of these are additional payment modes where we're widening up the kinds of transactions that we can do something for. And that includes buy now, pay later and pay now which is the Debit+ debit side of the equation, but we're not done there. We really have two sides of a network that we're focused on continuing to invest in.

On the consumer side, we talk about Debit+, we have a savings product. Consumers can now earn crypto and their savings yield and we hinted at our rewards product to come where we're going to give consumers a more rewarding shopping experience in our app. And we're going to keep focused on broadening the set of consumer features that you see in our network. And on the merchant side, we're not done either. You saw us buy Returnly last year, and that's a business that helps merchants deal with returns management.

We've done a little bit of SMB lending. We don't think it's the best time to do more of that, but we're going to keep iterating around additional merchant services because at the end of the day, the success of that and strength of that network is going to be do consumers prefer you as a way to pay and is there enough reasons for the consumers to have you top of mind and top of wallet? And are you driving better outcomes for your merchants?

And those two things work in a flywheel that we think is really powerful because the more valuable we are to consumers, the more valuable we are to merchants. The two reinforce each other quite well.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

Let's talk a little bit about regulation. We'd love to get your reaction to the recent report from the CFPB that was issued earlier this month. It seemed pretty balanced overall to us. Want to get your perspective. And investor, [ph] Miguel Am (38:12), has a related question around the potential plans to regulate BNPL businesses like Affirm and others. How is Affirm planning for that possible scenario of increased regulation and what would be the potential financial impact of such regulation?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

First of all, I would encourage everyone out there to read the report. If you're an investor in Affirm or anybody in this space. I think the Bureau did a really good job of taking the data request in and giving the world some things to think about. And in particular, there's several parts of the report that break down the wide variance of practices across the players in the space. And my favorite paragraphs was where they break down the late fees that were charged by the five different players surveyed. And of course, one of those players had no late fees. And I don't think I'm disclosing much to tell you that was us because we don't do that. And some players had really, really high levels of late fees. And there's two ways to think about late fees. It's a crutch against not doing the underwriting. It's a stick in the carrot and stick around repaying it.

But it's also a critical revenue source for some of the players. And the cool thing about Affirm is we would, of course, welcome any sort of focus on eliminating late fees or junk fees as you begin – they began being labeled, I think, by some regulators, because we don't charge them. We from day one have said we are going to make our product so consumer-oriented. We're never going to be in a position where we profit off of a consumer's misfortune or mistake. We won't let that happen. Because of that, our North Star has always been there. And so we welcome a focus on that.

Another area that's we've been hyper-focused on since the day we launched was around transparency. It's one of our core values here. And I think the [indiscernible] (40:07) report actually outlines that it's a bedrock of our financial ecosystem here is that people should understand what was happening when they enter into a transaction. And that's why we've been so insistent on showing what we call a Truth and Lending Act compliant disclosure. That's a lot of words that happen when you check out that make it very clear what the obligation is that you're going through. We call all of these things loans. Some of our competitors go either way to say these aren't loans. And our approach has been, one, we want to be transparent to the consumer. We understand that they're loans, we're going to underwrite every transaction because it's important to make sure the consumers don't extend themselves. And we never going to charge late fees. And all that puts us in a very different spot.

As you read the report, the things that the Bureau is focused on, we believe, where we're showing a lot of market leadership in. And so we look at some of the things that I think our competitors have to do to catch up to our approach and that's going to slow them down. They're going to invest in more consumer compliance. They're going to add disclosures. They're going to have to figure out how to still drive the conversion impact even though they're going to have to call these things loans potentially. And we think that puts us in a really good spot. And yet, as we talked about before, I think you and I had a chat a few quarters ago. It's always important anytime you talk about regulators to have enough humility because no one's perfect, and we certainly do and are aware of that regulation can continue to change business models. But we read the report with quite a lot of optimism around where the future of regulation might go in our space and really to our benefit in terms of leveling the playing field and bringing in the kind of consumer orientation and transparency that we value widely to everybody in the market.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

Do you think that the relationship that both Affirm and some of the other BNPL providers have with the traditional bureaus will formalize and increase over time?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

I think that is one area of real change that's probably most uncertain as there really isn't a solution yet. And so while I think some players and I think even most players want to find a solution, I don't think it exists yet; and yet, I think we're certainly focused on it. And I would just encourage anyone to stand by for more updates there as we continue to progress.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

Just coming back to the higher interest rate environment, and you talked about, obviously, some of the implications for funding costs at Affirm. How does Affirm then think about the notion of potentially passing some of those higher funding costs on to consumers in the form of higher interest rates on your interest-bearing loan products? And maybe give a little context for those who may be less familiar just around what sort of rates your interest-bearing loan products have and how those compare with traditional credit cards.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. So our products have APRs that range from 0% and when we say 0% to true zero. So unlike some other tricky financial products out there that kind of have a got you somewhere in there, our products, when they're 0%, they're true zero. Consumers never pay anything. All the way up to 36% when you calculate it on an APR basis. But it's important to think about our consumer and how they think about that. APRs matter a whole lot for consumers when you're thinking about revolving on a piece of debt. And so they're thinking about how the carrying costs of that obligation. Our products, because they're all closed end and capped, have a different way because they think about it in dollar terms.

And so there's a lot less sensitivity when you take a six-month loan, a few points in APR tend to not be the highest point of sensitivities to consumer. And so we feel like we do have that lever available to us, but the -- some of my best mentors and advisors will tell you it's important not to use leverage just because you have it and that I don't think we intend to pass along all the costs onto the consumer. We have other things that we can do. As I mentioned before, we have a lot of product differentiation. And so one of the things you can do to manage the funding cost in a loan is shorten its duration. And you have to be careful with that because you want to also make sure you don't stretch the consumer too far because a shorter duration loan has a higher payment. But that's a -- we have a lot more complexity to how we tackle the problem than simply funding costs are up so you've got to charge somebody more money.

We can find ways to still create these transactions and still add a lot of value to the consumer without necessarily passing it along. And yet, we do think we have that lever and we're not afraid to demand that we get the compensated in the revenue lines for the products that we have. And so when we add value for the merchant or add value for the consumer, we do expect to earn the kind of revenue that we need to support the transactions.

And so you'll see us continue to experiment there, but the fact that we have the lever is one of the reasons we have so much confidence in our ability to deliver our unit economics in the long run.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

In any given quarter, you guys tend to have maybe 25%, 30%-plus of your transactions coming in directly from the Affirm website or the Affirm app as opposed to a consumer using Affirm through a merchant's website or a merchant's app. How do you think about the potential long-term balance between those two and how the value proposition perhaps is a little bit different for both consumers and merchants in each scenario?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. When we're on the merchant site or an [ph] incredible (45:53) conversion tool where consumers [ph] who have (45:57) seen us before know the value of the product and those who haven't learn that they can pay for things over time and that drives extra conversion for the merchant. And when it's through our app, we're actually a source of traffic for the merchant and that's a whole different value add to the merchant. I can't see a world where we're not investing heavily on both. As you've seen in the past year in particular, as we invested heavily in scaling the user network, you've seen a slight drift more towards the merchant originate transactions as we've launched with Amazon and Shopify. And yet we have talked a lot about our ambitions in our super app where we think the users transacting in that app are really important to the merchants in the long run.

I think you're going to see us wanting to invest in both and for different reasons. And I think the business models across the two have some different flavors. You have an opportunity to earn different revenue whenever you're the source of users versus just the conversion. And in any event, the experience only works if it's only adding value to the merchants, if it's delightful for the consumers. And so I think it's really important to have a really delightful shopping experience in the app that's rewarding and engaging, but also have the kind of a streamlined and seamless checkout experiences on merchant sites.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

Your relationship with Stripe has gotten some amount of attention. I wanted to understand a little bit more about the nature of the relationship, perhaps how it has been evolving, and if you can talk about just the benefits that Affirm derives from this partnership.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. For us, it's about distribution. And the reason why we've partnered with Stripe and others in this space is about our ability to turn on Affirm's buy now, pay later solutions into their merchant base very quickly and easily. A lot of what we did with Shopify -- on the Shopify merchants in a Shop Pay context is a similar flavor of this but we wanted to make it really easy for merchants who wanted to use our product to flip it on. And that's certainly the case with Stripe. I think it's a good example of just how big this market really is and the opportunity ahead for us.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

So I want to also talk a little bit about the funding side of the business. Obviously, the model depends to some extent on the willingness of third-party to buy some portion of the loans that you guys are originating. So I've got a couple of questions on this, but maybe the first one is just talk about the types of counterparties that you tend to engage with the most and perhaps how that has been evolving a bit over time especially as credit markets are obviously experiencing some amount of volatility.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.
A

Yeah. I think the credit markets are experiencing a lot of volatility. I think maybe one of the things I'm most proud of in the Affirm team is we've managed through that volatility in ways that I really don't think any other can. We did a -- it's a really technical but excuse me for a second, we reopened our 2022-A securitization deal and we priced it just ahead of the CPI print earlier this month. And I'm so proud of that because we looked at it and said the market was open for us, it was constructed then we took advantage of that. And we are -- we were lucky in the timing of that transaction, some could say. But again, luck is about when preparation meets opportunity. And the opportunity was there, we're prepared and our capital team is always working with counterparties and the market to make sure that we can take advantage of those opportunities when they present themselves.

With respect to our loan buying relationship, we call it our forward flow program, here we sell our whole loan so the loans get originated then we sell them usually 2 times or 3 times a week to counterparties. And they're taking on all of the risk and all of the eventual yield. And we make some gain on sale associated with those transactions. And it's really important to us to have a diverse set of counterparties in any funding model but especially so in our forward flow program. So we have things ranging from pension plans to regional banks to insurance companies to even hedge funds. And they all have a different orientation, they all think about risk differently. And that's important to us because we don't want any one event happening in the capital markets, in the debt markets to cause multiple of our counterparties to have the same reaction.

And so, we're really proud of the level of expansion that we've driven. In our Q3 earnings call, we talked about a little over $9 billion in committed funding, in over $10.6 billion of committed funding in the last quarter. And we're going to keep growing that because our funding is committed and we build that first and we originate into that. And we're going to keep doing that. And we've demonstrated an ability to do that with the diverse set of counterparties.

And the reason we've been able to do that isn't just because we have an awesome capital team and we really do. It's because of the focus we have on generating assets that have really good economic content. If we take care of the asset, if we make sure that the loans that are originated in our platform have enough economics in them, that our capital partners can get rewarded alongside Affirm's P&L getting rewarded for that origination activity.

Jason Kupferberg
Analyst, BofA Securities, Inc.
Q

Yes. So one of these counterparties is maybe considering buying the loans of Affirm versus perhaps another buy now, pay later provider. What do you think might be some of the distinguishing factors of the Affirm loans that would make them more attractive as you talk about that economic content?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.
A

Yeah. I think a lot of these forward-flow partners are looking at unsecured consumer assets broadly, our consumer assets broadly. And in that context, the Affirm asset is -- got a lot of advantages. One, we're really careful in how we run the business and even if you can't get confidence that we're really good at underwriting, you know the short duration asset is it puts us in a different position versus anybody originating five-year personal loans. And so the shorter duration asset gives us flexibility to manage through the cycle and I think a lot of our investors like that, a lot of our investors really like the consumer orientation. As important as it is to generate assets that have economic content, it's also important that you're building a long-term business. It's a lot of work to get going with one of these relationships and the last thing they want to be worried about is whether or not you're going to be around in a few years. And so they're invested in the infrastructure and making sure that you can generate enough capacity because they have a business that they're running behind it.

If you're an insurance company, you want to make sure that we are going to continue originating for years and that we treat consumers right so that we don't have to worry about some of the concerns that you might have around, say, the regulatory environment. And so I think it's those factors and then, ultimately, it comes down to the yield. Can you generate the yield that you want to commit to and can you can you do that in a way that's reliable and consistent and we talk a lot internally about just how important it is that we do that as a true constraint on the business, the good unit economics that we have, our requirement for that to be the case. And so part of the reason we have so much confidence in that is because we know we have to do that anyway if we're to grow the capital base in the business.

Jason Kupferberg
Analyst, BofA Securities, Inc.
Q

So overall, it sounds like you're pretty comfortable with the diversity of your funding mix and the variety of counterparties and, obviously, the aggregate level of committed funding that exists despite everything going on in the credit market and more broadly in the macro. I mean, just to drive the point home because I'm not sure that's [ph] really an issue (53:55).

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.
A

Yeah. It's not easy, okay? It truly is volatile out there. And yet, we enjoy a very special position in this market. I think my – the words I used on our last earnings call were we're very fortunate that we're not worried about how we'll fund this business. We're not out trying to reinvent a new funding model. We're not out trying to figure out how do we solve the problem. We're truly just scaling into it. And yet it's hard. And I think the team that we have working on it earns every penny of their compensation because it's really hard and I don't want to sound cavalier about it because it's hard and it's volatile, but we really are quite fortunate in that we're not worrying about how we fund the business. We're not worried about liquidity. We have ample liquidity and ample funding ahead of us.

Jason Kupferberg
Analyst, BofA Securities, Inc.
Q

I wanted to come back to the split pay mix a bit which is the term Affirm use as you mentioned earlier. But four payments over six weeks essentially, probably 20%, 25% I think of your GMV now is split pay. Most of that is Shopify today. Sounds like that split pay mix probably will increase over time. So can you just talk us through what the implications are for kind of overall Affirm unit economics as that potentially unfolds?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.
A

Yeah. So the – we do think it will grow over time. And I think a year ago, probably even more so, one of the things that happened in our Q2 last year is that we had an explosive growth with Amazon and in Amazon we launched with an interest-bearing program. And so it actually slowed down on a proportionate basis the rise of split pay in our portfolio. But over time, we do expect that to continue to increase on a GMV basis. Our split pay loans have lower revenue, and so we we'll make 4% or 5% merchant fees. There's no consumer fees at all in our split pay loans, see a 4% to 5% revenue yields and again kind of 1% to 2% range depending upon the partner in the program in terms of our unit economics.

And so if you think about that program, it's necessarily less profitable, but it's super short in duration. And so you start to annualize either that revenue number or annualize that margin number. And it's a really attractive profile business. We really like it. I mean, it's also super capital-efficient. So while we do put all of those loans on our balance sheet, not all, but the vast majority are on our balance sheet, we turn it over 15 to 17 times a year. And so you can fund a tremendous amount of GMV with very little funding capacity. So it's really efficient product with lower revenue and lower unit economics, but with a really attractive kind of annualized performance. And so we love that business and we'll keep investing in it. And yet one of the moats we had is that we're able to provide multiple products. And so we're not shying away from the rest of our portfolio. We think in this environment especially, it's really important that you're showing up with the full product suite for merchants and consumers.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

Great. Very helpful. We're going to wrap up with one more question from a retail investor, [ph] Manu (57:15), relates to compensation for Founder and CEO, Max Levchin. [ph] Manu (57:22) is asking about the structure of Max's compensation which he seems to believe is an extremely high number of $451 million. But not sure if you want to perhaps comment on the structure of Max's compensation.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. I appreciate the question and, hopefully, I can walk through maybe some details that might be missing, [ph] Manu (57:46). First and foremost, our Founder and CEO walk through maybe some details that might be missing [indiscernible] First and foremost, our Founder and CEO earns a nominal cash salary. It was $10,000 in fiscal 2021 and I think if you stack him up against pretty much any other CEO, it's a pretty impressive comparison. And all of that compensation that you're alluding to [indiscernible] (58:05) for our CEO links to a multiyear stock option grant that we made at the time of the IPO. An important piece of context is, as we were thinking about that grant at the IPO is that Max, as we talked about in our proxy, had not received a grant since he started the company. So the compensation to our CEO and Founder was essentially nothing. Everything he earned was what he had built here.

And so what we wanted to do at the IPO was put in place something that aligned incentives between the shareholder and the CEO for creating sustainable and long-term shareholder value. And so if you go back and look at the table, the vesting conditions for each tranche of shares imply share prices that are a substantial premium to where they are today. The numbers that you might see out there relate to how you account for these.

And so the reporting rules dictate that you value the grant at the time of the grant and you expense it over the life. And it would be really important to note that if you were paid out in full, we would have created more than $70 billion in shareholder value. And so when you think about it like that, we think that's a kind of an unfair comparison. And you can look up all his information that the grant is spelled out in detail in all of our documents. But we really feel like that's an aligned interest point. It is a mistake to think that that's the actual compensation or cash received by our Founder and CEO. And in fact, I think the strike price of all of his options is actually above where we're currently trading. And so we think that this is a huge incentive aligning aspect to compensation that we did at the time of the IPO.

Jason Kupferberg

Analyst, BofA Securities, Inc.

Very helpful clarification. Good way to end the conversation. We covered a lot of ground. Really appreciate your time, Michael. Thanks to everyone who listened in and submitted questions. Thank you.

Michael Linford

Chief Financial Officer, Affirm Holdings, Inc.

Thanks, everybody.

Jason Kupferberg

Analyst, BofA Securities, Inc.

Bye-bye.