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Affirm Holdings, Inc. (AFRM)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, ladies and gentlemen. Thank you for standing by. Welcome to the Affirm Holdings Fiscal Second Quarter 2021 Earnings Conference Call. At this time all lines have been placed on mute to prevent any background noise. Following the speakers' remarks, we will open the lines for your questions. As a reminder, this conference call is being recorded. I'd now like to turn the call over to Rob O'Hare, Senior Vice President of Finance, to begin.

Robert O'Hare

Senior Vice President-Finance, Affirm Holdings, Inc.

Thanks, operator. Before we begin, I would like to remind everyone that today's call may contain forward-looking statements. These forward-looking statements are subject to numerous risks and uncertainties including those set forth in our filings with the SEC which are available on our investor relations website including our prospectus filed on January 14, 2021. Actual results may differ materially from any forward-looking statements we make today. These forward-looking statements speak only as of today and the company does not assume any obligation or intent to update them except as required by law.

In addition, today's call may include non-GAAP financial measures. These measures should be considered as a supplement to and not a substitute for GAAP financial measures. Reconciliation to the most directly comparable GAAP measures can be found in today's earnings press release which is available on our investor relations Web site.

Hosting today's call are Max Levchin, Affirm's Founder and Chief Executive Officer; and Michael Linford, Affirm's Chief Financial Officer. With that, I'd like to turn the call over to Max to begin.

Max R. Levchin

Founder, Chief Executive Officer & Chairman, Affirm Holdings, Inc.

Thanks, Rob. Thank you, all, for joining us for our first earnings call as a public company. We are pleased with the results for the quarter which included revenue growth of 57% year-over-year and a 55% year-over-year increase in quarterly gross merchandise volume to a record $2.1 billion as our product offerings continue to resonate with consumers and merchants alike.

In the second quarter, we also grew active consumers by 52% and our merchant base by 90% from the prior year. Michael will provide more details on our second quarter performance in a few minutes, but since this is our first earnings call, I'd like to spend some time providing a brief overview of Affirm, the industry tailwinds driving our growth and our strategic initiatives.

Affirm was founded almost a decade ago with the mission to build honest financial products that improve lives. We knew that consumers were tired of the constant penalties like late fees and deferred interest from credit cards. And we knew that merchants needed new payment solutions that could help them attract and retain customers while avoiding discounts and promotional gimmicks which can dilute their brands and their bottom line. Since the beginning we focused on building a new kind of payment network, the first to align its own success with the success of both consumers and merchants.

Affirm wins, but our consumers and our merger partners win. In the last 12 months we've empowered 4.5 million consumers to take control of their finances enabling them to pay for the things they want and need over time almost anywhere in the US. We've also helped merchants drive growth by adding new customers, accelerating sales, and increasing conversion. We've enabled over $12.7 billion in transactions in the past four and a half years and we've never charged a late fee or $0.01 of deferred interest.

Our approach has led to trusted relationships on both sides of the commerce ecosystem. Our payment platform has enabled us to advance our mission and enhance the role we play at the center of commerce for both consumers and merchants.

Before I go into the details of what we have built so far and where we're headed, I wanted to give you a sense for how consumers feel about Affirm in their own words. For example, a military mom who otherwise would not have been able to attend the graduation of our kids told us to make it to the graduations I was able to get tickets through Affirm and make payments on such expensive plane tickets that I would not normally be able to get. It's been so nice. Payments are reasonable and the app is easy to use.

Another satisfied consumer, for a company to be completely honest about no late fees and working with you on timing of payments is a godsend. I couldn't take Affirm enough for being such a great company. We have received many more testimonials such as these which validate our founding mission and empower us to deliver on that mission every single day.

Our platform consists of three core solutions, a point-of-sale payment solution for consumers, a merchant commerce technology solution, and our Affirm app. Our point-of-sale payment solution gives consumers control and flexibility at merchant checkout. After selecting Affirm as a payment option, consumers enter up to five pieces of information and then choose how they wish to pay. Payment schedules include biweekly and monthly options and terms range from as little as six weeks to as long as 48 months.

Our merchant technology solutions help merchants from small businesses to the world's largest retailers more efficiently reach new consumers and drive incremental sales. Not only do we enable merchants to address affordability and increase their customers' purchasing power, we also provide them with valuable high-quality data that they cannot get elsewhere. This includes item level data, repayment data, consumer behavior data and repeat purchase data. These insights can be used to more efficiently target customers, tailor promotions, and achieve a greater return on marketing spend.

And third, the Affirm app, also known as our marketplace, is where consumers can discover relevant merchants and get exclusive offers tailored to their spending and shopping habits. In addition to being a great tool for consumers, it's also valued by merchants. Merchants love that their outreach can be highly targeted through placement on our app, making it a great vehicle for customer acquisition. The app also offers consumers an Affirm virtual card that can be used almost anywhere in the US, a simple interface where they can manage their payments and a place to open a high-yield savings account.

In the December quarter, approximately 1.2 million transactions originated from Affirm properties, twice as many as we saw in the same period last year and approximately one-third of our overall transaction volume.

As we look to expand our current network, there are several strong tailwinds powering our business and combining to create a massive and durable opportunity for Affirm. Consumers, particularly millennials and Gen Z, have lost trust in financial institutions and increasingly prefer a more flexible and innovative digital payment solutions in lieu of traditional credit payment options.

In 2020, these younger generations represented over 160 million US consumers with more than $2.5 trillion in estimated spending power. Additionally, every element of commerce is moving online. Even as total worldwide retail sales declined by 3% in 2020, retail e-commerce boomed increasing by 27.6%. This significant change in consumer behavior, coupled with the fact that the cost to acquire a customer and convert a sale are two of the biggest challenges facing merchants, are fueling demand for Affirm.

By continuing to leverage our core strengths and competitive advantages, we believe we can capture an even larger portion of the ecosystem we've set out to reinvent. Our proprietary technology is custom-built from the ground up so we don't have the constraints of legacy systems. This means we can efficiently respond to changes in the world, scale quickly, and innovate a new product. And we've maximized the value of our data to benefit our consumers and merchants, leveraging item level data, repayment data, consumer behavior data, and repeat purchase data to more finely press transactions and personalize experiences, all while managing risk.

Further, our ability to service all transactions from low AOV to high AOV online and offline, our flexible payment terms, and a breadth and depth of our merchant and partner network set us apart. As a result, we see strong consumer satisfaction. In calendar year 2020, approximately 67% of purchases were made by repeat Affirm users, and we're proud to have earned a Net Promoter Score of 78, a score that is on par with some of the most admired tech brands and significantly higher than the scores of traditional financial institutions. We can accommodate and partner with merchants regardless of industry size, AOV, or customer profile.

During the quarter, we generated significant traction with new merchants, growing our affiliate merchant base to over 650 paying merchants. Our merchant wins range from Alice and Olivia, Tom Ford International, to Neiman Marcus, and Williams-Sonoma, to some of the largest brands in the world. We recently signed an agreement with American Airlines and expect to be available on aa.com in the American Airlines app soon. Mostly excited about the new three-year agreement with Walmart that we signed in January. This wide range of marquee brands demonstrates our broad merchant appeal.

We also added new strategic partnerships in the quarter that increase our access to millions more consumers and hundreds of thousands of merchant. For example, we recently launched with Adyen, a global omni-channel payment platform for many of the world's leading businesses, as well as Inntopia, positioning the firm as a leader in the ski resort and ticketing space. Additionally, we continue to make progress on our partnership with Shopify first announced last summer. We are currently in beta with nearly a hundred merchants, and have been very pleased with our results so far.

Our partnership with Shopify is enabled through our point-of-sale API product which allows partner platforms to deliver buy-now-pay-later with a customized user experience to the merchants and consumers that are on their platform. The deeper integration for external commerce platforms enables to offer Affirm as a service to any partner.

Similarly, in December, Rakuten, a leading cashback shopping platform, debuted with us as the launch partner for our Marketplace API which allows consumer shopping platforms to offer their customers Affirm financing via virtual cards. We're excited to augment our strong merchant and consumer networks through these large high-growth partners like Shopify, Rakuten, and many others.

Just a few weeks ago, we made our first strategic acquisition purchasing PayBright, one of Canada's leading buy-now-pay-later providers. We expect PayBright's complementary merchant relationships and first-mover advantage in Canada to enable us to expand our scale and reach across North America.

We're very pleased with the results on the acquisition so far, with GMV performance in Canada exceeding our expectations quarter-to-date with growth in both split pay and pay monthly offerings.

Key merchants driving this growth include Samsung both online and in-store, as well as Hudson's Bay, Canada's largest department store retailer. As we look ahead, we believe we can address not only the $600 billion of e-commerce spent in the US but the $7.6 trillion of card spent processed online and offline at merchants in the United States.

Furthermore, by continuing to bring merchants new high quality and loyal customers, we believe we can address a large portion of the estimated $1 trillion they spend on customer acquisition. We have successfully demonstrated how our solutions can enable and accelerate commerce for larger, more considered purchases. A key principle of our next phase of growth is to expand into higher frequency purchases by investing in our split pay product, ramping up our partnership with Shopify, and making strategic investments in marketing.

We also made our first foray into brand marketing in the second quarter with a holiday campaign that featured Keke Palmer and focused on the benefits of Affirm over traditional credit cards. The campaign was amplified by Jimmy Kimmel Live, The Late Show with James Corden (sic) [The Late Late Show with James Corden, Hasan Minhaj, Whitney Cummings, Ashley Park, and other prominent personalities.

During the holiday season, Affirm was prominently featured in more than 100 merchants marketing and advertising. The response to these marketing efforts has been very positive, and we have seen a 10-point increase in brand awareness quarter-over-quarter. We believe these actions combined position us well to increase engagement with both consumers and merchants leading to increased transaction volume on our platform.

We also see significant opportunity to develop new products that can define the future of commerce and plan to continue making investments to drive growth. Take our savings product, for example, we've seen an interesting halo effect where our savings account growth has benefited from marketing and communications to our customer base that are focused on other products, and while our savings product isn't a large part of our business right now, it is great to see our existing consumers use savings accounts to deepen their engagement with Affirm and to see how new consumers start their Affirm relationship with a non-lending product.

In addition, we've introduced split pay across our point-of-sale, merchant platforms and in our app. The split pay product, which is suited to higher frequency, lower AOV purchases, showed approximately 71% higher repeat transaction rate [ph] but our (12:47) core installment loan product over the November-December holiday period.

And while we got our start in the high AOV segment and have expanded into the lower AOV more frequent purchase area, we believe there's ample opportunity to further expand our use cases eventually even addressing the largest category of all, daily spend. We expect all of this and more to further our ability to expand our consumer and merchant base, help our merchants grow their revenue on our platform, and develop new innovative solutions to establish the ubiquity of our network and breadth of our platform.

Finally, I want to thank all our Affirmers for their incredible dedication to our mission over the last nine years. Each day you strive to put consumers back in control of their finances and to be a powerful revenue accelerator for merchants. I'm so grateful for you and so proud of how we're transforming commerce.

With that, I'd now like to turn the call over to Michael to discuss our second quarter financial results.

Michael Linford

Chief Financial Officer, Affirm Holdings, Inc.

Thanks, Max, and good afternoon, everyone. Before we get into our fiscal second quarter 2021 results, I first want to talk about our business model and capital funding model. We measure our success across a number of merchant and consumer KPIs including: gross merchandise value, or GMV, the total dollar amount of all transactions on our platform in the period net of refund; active consumers defined as a consumer who engages in at least one transaction on our platform in the previous 12 months; and transactions per active consumer, the average number of transactions that an active consumer has conducted on the platform in the previous 12 months.

As Max has mentioned, our business model is aligned with the interest of both consumers and merchants. We've proven that aligning incentives can result in great outcomes for our consumers, our merchants, and Affirm. We generate revenue in several different ways. First, merchant partners are charged a fee on each transaction processed through the Affirm platform. We refer to this as the merchant discount rate or MDR. We also generate revenue through interest earned on consumer loans we hold on our balance sheet purchased from our originating bank partners.

In recent quarters, roughly 54% of our loans by GMV carried an interest rate borne by the consumer. A smaller portion of our revenue comes from interchange fees earned when consumers use our virtual card for purchases on or offline. While virtual card revenue has contributed roughly 5% of our total revenue in recent period, it represented an important product capability that allows consumers to use Affirm's product at any US merchant that accepts credit card. Additionally, we sell a portion of the loans originated in our platform to third-party investors and recognize a gain or loss on the sale of these loans.

Lastly, we earn a fee for providing loan services on behalf of third-party investors that have purchased consumer loans from us. Our transaction costs are made up of loss on loan purchase commitment, a loss incurred on a subset of loans which we purchase from our originating bank partner at a price that is above the loan's fair market value. This mainly occurs with 0% APR loans and loans with below market interest rate.

Provision for credit losses which consist of amounts charged against income during the period to maintain an allowance for all future expected credit losses; funding costs which consist of the interest expense we incur on our borrowing and the amortization of fees and other costs incurred in connection with our funding facilities and consolidated securitization; and lastly, processing and servicing expense which consists primarily of payment processing fees, third-party customer support and collection expenses, salaries, and personnel-related costs of our customer care team, and allocated overhead.

We fund our business through three primary channels: warehouse credit facilities where we borrow against loans retained in our balance sheet; forward flow relationships where we sell loans to third-party investors; and securitization vehicles where we bundle consumer loans into structured debt offerings.

In January 2021, we entered into our first revolving credit agreement with a syndicated commercial bank for an unsecured revolving credit facility to further enhance our corporate liquidity, so the facility remains undrawn to-date. We currently have no other drawn corporate debt on our balance sheet.

Our funding model is built to be durable and resilient as demonstrated during the pandemic. Not only were we able to retain our existing funding but we added over $2 billion of additional committed capital and introduced two securitization programs into our ecosystem in calendar year 2020. We were able to do this in large part because of the high-quality assets we produce which generate predictable servicing and interest income. Additionally, the assets we hold in our balance sheet are short in duration and thus do not need to withstand multiple credit cycle.

Our performance during COVID-19 highlighted the quality of our assets and the capabilities of our proprietary risk management and underwriting approach. As of December 31, 2020, our delinquency rates as a percentage of our loan portfolio and excluding the impact of our payment deferral program were approximately 41% lower as compared to June 30, 2020 and 63% lower as compared to December 31, 2019.

In addition, as of December 31, 2020, our trailing three-month gross charge-off as a percentage of loan portfolio and excluding the impact of our payment deferral program were approximately 53% lower as compared to June 30, 2020 and 67% lower as compared to December 31, 2019.

As a result of our consistent loan performance and strong investor demand for our assets, we have been able to expand our platform at scale while decreasing the equity capital requirement of our loan business. While we added $1.5 billion to our total platform loan portfolio in calendar year 2020, the relative equity capital required to service the portfolio decreased from 10% as of December 31, 2019 to 8% as of December 31, 2020.

Turning now to our fiscal second quarter results for the three-month period ending December 31, 2020. GMV increased 55% year-on-year to $2.1 billion. The increase of GMV was driven primarily by the 90% expansion of our active merchant base to approximately 7,890 at the end of the quarter from approximately 4,148 active merchants in the same time last year and organic growth in active consumers which grew approximately 52% year-on-year to 4.5 million.

Providing a little more color on the composition of GMV, we typically assess our GMV mix across the two different dimensions. First, zero percent First, 0% versus interest-bearing GMV. For the quarter ended December 31, 2020, 0% APR loans accounted for 46% of our total GMV, compared to 40% for the three months ended December 31, 2019.

Affirm versus not Affirm-initiated transaction. We tracked the portion of transactions originated on our Affirm's own properties to assess the strength of our consumer network. For the three months ended December 31, 2020, 32% of our transactions occurred on Affirm's property, compared to 26% in the same quarter in the last fiscal year.

Industry diversification, we believe the diversity of our merchant partners provides our business with a unique competitive offering as we are not tied to any one sector of the economy. During the three months ended December 31, 2020, no one segment accounted for more than 31% of our volume. Over the last 12 months, the largest and fastest-growing segments were sporting goods and outdoors which includes merchants such as Peloton, Mirror, and Rad Power Bike, and home and lifestyle which includes merchants such as Purple, Wayfair, and West Elm. Both of these segments had pandemic tailwinds.

Conversely, our small segment over the last 12 months was travel and ticketing which declined 47% year-on-year and fell from 11% of our volume in calendar year 2019 to only 3% in calendar year 2020. Notable merchants in this space include marquee brands such as Expedia, Priceline, and Delta Vacations. The strong GMV growth drove an increase in total revenue of $74.1 million, or 57%, compared to the same period last year. Total revenue as a percentage of GMV was 10%, an increase of approximately 14 basis points compared to the same period last year.

Total transaction costs increased 23% year-on-year, significantly less than the 57% annual growth in revenue to $114.1 million. Transaction costs as a percentage of GMV were 5.5%, a decrease of approximately 141 basis points compared to the same period last year. The increase was primarily driven by a 59% increase in loss on loan purchase commitment due to a significant increase in the proportion of 0% loans purchased from our originating bank partners during the period and a 48% increase in funding costs primarily due to a 99% increase in our average debt balances corresponding to our 81% increase in average loans held for investment, and partially offset by significantly lower average market interest rate.

Our debt balances include only [ph] funded debt (22:21) in fiscal year Q2 2020, now also include our fixed rate note held by securitization trust issued during the current fiscal year. And a 44% increase in processing and servicing expenses primarily due to an increase in third party loan servicing and collection costs and an increase in payment processing fees due to an increase in servicing activity and payment volume. These increases were partially offset by a 42% decrease in provisions for credit losses due to lower credit losses and improved credit quality. For all loans which we retain our balance sheet, we are required to hold an allowance for credit losses. The provision for credit losses are generally determined by the change in estimates for future losses and the net charge-offs that occur in the period.

During the three months that ended December 31, 2020, the stronger than expected credit performance of the existing portfolio and an improved credit outlook resulted in a decrease in the allowance for credit losses. This decrease was offset by allowances recorded on loans retained during the period with higher credit quality and a similarly improved credit outlook as the balances of loans held for investment continue to increase, resulting in division expense of $17.5 million for the three months ended December 31, 2020. The combination of the decrease in allowance for credit losses is three months ended 31, 2020. And the overall credit quality improvement relative to the three months ended December 31, 2019 led the provisions for credit losses to decrease by $12.7 million or 42% compared to the three months ending December 31, 2019 despite the growth in the balance of loans held for investment.

Total revenue less transaction costs was $89.9 million in the second quarter, up 141% year-on-year. As a percentage of total revenues, total revenue less transaction costs was 44%, as compared to 29% in the prior year in the prior-year period. Total revenue less transaction costs as a percentage of GMV was 4%, an increase of approximately 155 basis points compared to the same period last year. This increase was driven by a release of allowance for credit losses due to strong credit performance in our loan portfolio which resulted in lower provision expense.

Technology and data analytics expense increased by $10 million or 32% year-on-year. This increase was primarily due to an increase in engineering, products, and data science personnel costs, as well as to an increase in the data infrastructure and hosting costs. These increases were partially offset by a decrease in underwritings data.

Sales and marketing expense increased by $31.5 million or 411% year-on-year. This increase was primarily due to $17 million of non-cash expense associated with amortization of asset imposition associated assets associated with our commercial agreement with Shopify, which was executed in July 2020. Additionally, there was a $10.7 million increase in brand and consumer marketing driven by our holiday shopping and brand activation marketing campaign, which resulted in meaningful inclusion in over 100 merchants marketing advertising over the holidays. Furthermore, we incurred $0.8 million of one-time marketing costs and professional fees resulting from our initial public offering.

General and administrative expenses increased by $10.2 million or 33% year-on-year. This increase was primarily due to an increase of $4.5 million in personnel costs as we grew head counts in our finance, legal, operations, and administrative organizations. Additionally, professional fees increased by $4.3 million during the period to support the PayBright acquisition, our initial public offering, and regulatory and compliance program. G&A expenses included $2 million of one-time costs associated with our initial public offering and the acquisition of PayBright.

Operating loss for the second quarter was $31.7 million, as compared to $32.6 million in the prior-year period. Excluding our non-cash Shopify expenses, depreciation and amortization, stock-based compensation expenses, and one-time costs associated with our initial public offering and the acquisition of PayBright, adjusted operating loss was $1.8 million, as compared to $21.1 million in the year-ago period.

In the second quarter, net loss increased to $31.6 million from $31 million in the same period last year. Subsequent to the end of the quarter on January 15, 2021, we closed our initial public offering of 28.3 million shares of the Class A common stock at an offering price of $49 per share. The proceeds before expenses to us from the IPO were approximately $1.3 billion.

A couple of things to keep in mind when thinking about our fiscal third quarter. In December, Peloton began delaying the capture of transactions based on shipment date, which is a change from the previous approach of capturing funds to check out. This change resulted in approximately $83.9 million of GMV not captured in the current period, shifting a significant amount of revenue from our fiscal second quarter and to future fiscal quarters. The effects of this are reflected in our guidance as well. Additionally, our third quarter results will be the first to include the financial impact of the PayBright acquisition. We are providing the following guidance for our fiscal third quarter and fiscal year 2021 based upon our current assumptions.

For our fiscal third quarter ending March 31, 2021, we expect GMV of $1.8 billion to $1.85 billion, revenue of $185 million to $195 million, transaction cost of $125 million to $130 million, revenue less transaction cost of $60 million to $65 million, adjusted operating loss of $47.5 million to $52.5 million, and a share count of 226 million.

For our fiscal year 2021 ending June 30, 2021, we expect GMV of $7.25 billion to $7.35 billion, revenue of $760 million to $780 million, transaction cost of $500 million to $510 million, revenue less transaction cost of $268 million to $270 million, adjusted operating loss of $120 million to $130 million, and a share count of 155 million.

Thank you again for joining the call today. We are now happy to answer any questions you may have. Operator, please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Thank you. Our first question comes from James Faucette with Morgan Stanley. Please proceed with your question.

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

Thank you very much. I wanted to ask just on consumer behavior, Max, and kind of what you're seeing there in terms of engagement and how people are kind of moving between originating or finding things through the Affirm platform versus through merchants where you already have acceptance. Just trying to see where there's some cross benefits there from your perspective and what you can track.

And then quickly, Michael, you highlighted some of the improvements and loan performance, et cetera, on various metrics. Can you maybe give a little bit of color as to what you think the key drivers of those improvements are? Thank you very much.

Max R. Levchin
Founder, Chief Executive Officer & Chairman, Affirm Holdings, Inc.

A

Oh, sorry. Thank you for the question. So I think we said it in the prepared remarks which I'm sure one could use [ph] to watch paint dry (00:30:46). On the order of a third of our transactions are now originated on Affirm properties. And the vast majority of that our existing users coming back and using Affirm as a starting point in their shopping journey. So I think that sort of speaks for itself. Part of our value proposition to the end customer isn't just, hey, you find us at the checkout counter and we are a better, more transparent, perhaps even lower priced way to pay, we're also a great way to discover merchants that offer sometimes zero interest, in our case the true zero interest transactions and also just have really interesting things to share with the customers. And so the Affirm platform in a form our app to marketplace is growing very nicely. We are investing in that very, very heavily. Michael, do you want to add? I think you're still muted, Michael.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. So, James [indiscernible] (00:31:55), yeah, sorry. In response to your second question, James, the quantifiables are around the [ph] BQs (00:32:04) and the gross charge-offs, both of which are down materially to last year. The key drivers are a function of the credit posture that we took this summer. So even though our book turns over fast, we still have a meaningful portion of the portfolio through the period from origination to Q1, and that credit posture was obviously tighter than where we were in the prior periods. We also, of course, continue to make improvements to our underwriting model, and what you're seeing there is just really good performance. I wouldn't expect us to continue at these levels. I think we're certainly having – taken a more loose credit posture coming out of the summer, but I think that's the biggest drive for the results in this period.

Just to...

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

And thank you – sorry I interrupted you, Max. Go ahead.

Max R. Levchin
Founder, Chief Executive Officer & Chairman, Affirm Holdings, Inc.

A

I just wanted to – [ph] I would love to give answers about (00:33:01) numbers. And so the one thing that I can tell you about the transactions originated on our platform, the year-on-year growth there was north of 100%. So not only is the Affirm originated transactions are growing, they are a triple digit growth in that right now.

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

Got it. Got it. And sorry back to Michael. When you said we wouldn't expect those to remain at this level, were you meaning in reference to kind of your credit box or the performance in delinquency? Just trying to clarify what you meant by we shouldn't expect them to remain at this level?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. Our delinquencies and charge-off rates are really at historic lows, and that's not how we intend to run the business.

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

Okay, great. Thank you.

Operator: Thank you. Our next question comes from Ramsey El-Assal with Barclays Investment Bank. Please proceed with your question.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.

Q

Hi. Thanks for taking my question this evening. I was wondering if you could give us some additional color on your expectations for the Shopify agreement in terms of the pace of the roll out, the magnitude of the eventual P&L impact, or any other commentary there would be helpful.

Max R. Levchin
Founder, Chief Executive Officer & Chairman, Affirm Holdings, Inc.

A

[Technical Difficulty] (00:34:27-00:34:42) So back to Shopify, the long and short of it is it's an enormous platform and the reason we were picked as their exclusive partner was because we are, if I do say so myself, an exceptional engineering team and we build things well and we take care and then take the time necessary.

So we'll continue testing the systems. We improved our – I think we added another third all the way up to almost 100 merchants to our beta program. Just since we saw each other, it would be in the roadshow, and we're very happy with how these tests are going. We're quite pleased with the conversion rates. We're getting the integration tightness, the uptime on all the metrics that we care about are doing well. That said, I think it's foolish to overpromise and under deliver.

So when we turn on fully, we expect it to be massive. It will definitely only turn on when we feel like it is ready for prime time including the scalability it takes to take on such an enormous amount of volume. So I would not expect to think overnight. But we will actually take our time, and we have tried to be conservative in our internal forecast, as well as what we tell publicly about when to expect this to happen.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.

Q

Okay. And then I wanted to ask also in the quarter, the yields, the GMV performance was amazing. The yields on the merchant network revenue came in a little bit below our model, and I'm just curious about what the drivers there are. I'm thinking primarily mixed but...

Max R. Levchin
Founder, Chief Executive Officer & Chairman, Affirm Holdings, Inc.

A

Yeah. It's a good question. There's two things to think about. One is the seasonality in our calendar Q4, fiscal Q2. The holiday shopping season tends to have a little bit of lower average order values and lower revenue yields. It's actually up I think about 10 basis points year-on-year for the same period. So I think the seasonality is probably the biggest driver which is really the mix that you see during the season. There's nothing material with respect to any sort of merchant pricing or mix shift around the end merchants to report there. It's more around just where the transactions tend to be this time of the year.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.

Q

Got it. All right. Thanks so much.

Operator: Thank you. Our next question comes from Matt O'Neill with Goldman Sachs. Please proceed with your question.

Matthew O'Neill
Analyst, Goldman Sachs

Q

Yeah. Hi. Good evening, Max, Michael. Thanks for taking my question this evening. I guess, Max, I wanted to touch on the sort of long-term strategics. So understanding starting today in the sort of higher AOV, a clear glide path moving into low AOV, you're starting to build out your own properties vis-à-vis the sort of customer acquisition channel and sort of purchasing through the app and website. You've also built savings account. So I was curious, what else is on the roadmap? Any kind of hints or guideposts to what we can be thinking about what may come next for a more comprehensive suite of sort of consumer services.

And then I'll just ask my follow-up now for Michael. Just going back to James' question around the credit is, is the outperformance on the provision here a byproduct of mix as far as getting maybe more growth from partners like Peloton which maybe skew more affluent higher FICO? And that's part of what will add back or was it the conservatism at the onset of the pandemic and now kind of working back out of that as we've got some more clarity around the hopeful recovery here? Thanks a lot.

Max R. Levchin
Founder, Chief Executive Officer & Chairman, Affirm Holdings, Inc.

A

Great questions. So if you're wondering why the dual mute thing is happening it's because we're also on the Zoom call and my General Counsel and Chief Legal Officer are staring directly in my face. And if I disclose any forward-looking statements I'm going to get into trouble. So I can't really tell you anything about our – okay, I'll try to say a few things without breaking any rules.

So one of the things that we're very excited about, and I think that that's an enormous unaddressed opportunity in the world of [indiscernible] (00:39:03) my favorite nomenclature, but the idea of transparent, easy to understand, cash-denominated or enumerated payments where consumers [indiscernible] (00:39:15) what's going on is something that's ubiquitous. And it has a purpose in high AOV transactions which obviously were very, very strong and then low AOV which is where we're now going very well.

There's an enormous other category and it's daily spend. And right now people are still using their tired old financial instruments with their overdraw and insufficient funds fees drawn over it, and I think someone, and it might as well be us, will bring some light into that part of the tunnel as well.

So we have really interesting ideas in that domain. A lot of what you're seeing in our products and our services today will improve markedly. One of the things that's really important to understand is that what we think the world sees today as sort of the combined BNPL sort of products it's very much conversion maybe 0.5, maybe 0.7, but there's a lot of improvement there. So, you should expect us to iterate on the existing products very, very actively.

One of the things that is sort of in the content that we read before which I don't want to sort of overlook, one of the things we have to do for Shopify that we take a lot of pride in is we basically rebuild major parts of Affirm to act as a service. So this idea of offering our product as a service that plugs into existing platforms in a organic way where the partner can offer these buy-now-pay-later transactions in kind of a single flip of a switch, all of their partner-participants benefit. Some of them we intend to bring to market in really, really big ways. And we're doing it already. We've built something like this for Shopify, but there is also one that we've launched with Rakuten which is quite a different platform and so on and so forth. And this is something that we are very excited about as technologists and also just by way of growing the business in a very different new kind of way. I'll stop before I start speculating about which cryptocurrencies we're going to work with. Michael probably has more substantive answers to give.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. Just on the credit side, just to be really clear, I mean, clearly as you do mix towards loans held loans outstanding for Peloton, you do see credit improvement. We see the same trend kind of Peloton and not Peloton. So that is less of an effect than the credit posture that we took this summer and the thing that we always do is do our best to look at with the macro environment is, and we'll try to take a credit posture that ensures that we run the business safely and can do the things that we need to do in the capital markets while still servicing our consumers and merchants.

And so the summer that looked like us being very careful and cautious, I think the provision release that you see this quarter, this reflects the fact that the reality is the consistent trend here on [ph] BQs (00:42:14) and charge-offs point towards this portfolio being quite healthy and that's also borne out by the kind of active participation we have going on in the capital markets right now.

Matthew O'Neill
Analyst, Goldman Sachs

Q

Thank you very much.

Operator: Thank you. Our next question comes from Dan Perlin with RBC. Thank you.

Daniel R. Perlin
Analyst, RBC Capital Markets LLC

Q

Thanks. Good evening, guys, and congratulations on the first quarter out of the box, exciting stuff. I wanted to jump back in on shopping installments just for a second. I know you're in beta. I think you said 100 merchants today. I'm just wondering what are – can you talk about maybe some of the early stage kind of attributes that you're seeing from those merchants? Here we're thinking about how that's going to influence this lower AOV channel acceleration, repeat use, those types of metrics, just anything I guess in the early stages there would be helpful.

Max R. Levchin
Founder, Chief Executive Officer & Chairman, Affirm Holdings, Inc.

A

Probably a little too early to say too much. I guess the metric that I'm most concerned with as the product CEO probably more than anything is end-to-end conversion. What we want to make sure is that when a consumer comes up for a transaction in shopping installments powered by Affirm, they don't have an experience that makes them think, maybe I'll pull up, enter the card, instead of next time because this was not smooth enough or wasn't simple or simple as I thought would be. And so we're very, very focused, and this is also why it will take time, and I don't want overpromise here. We want the experience of using shopping installments to be ideally the highest converting, smoothest experience for our customers, and we have a lot of work to do there.

That said, end-to-end conversion numbers are looking very good. I am looking into my chat box to make sure I'm not disclosing anything that I'm not allowed to say out loud, but we're feeling very, very good about those metrics. The other one obviously that really matters is share cards. Ultimately, we are valuable to merchants at the percentage of transactions we cover for them. And end-to-end conversion is a driving metric there, but over time it's consumer repeat rates and acceptance that influence our share cards.

And so I will give the qualitative numbers for now. Hopefully next quarter we can come back with some numbers that will be actually grounded in more than 100 which is – [indiscernible] (00:44:57) really a handful of merchants. So it's a little too early to declare that.

Daniel R. Perlin
Analyst, RBC Capital Markets LLC

Q

Understand. That's helpful, though. And, Michael, can you just maybe speak to the funding capacity available relative to kind of the GMV growth that you guys are expecting? We seem to get that question a lot. Just making sure everyone understands the velocity of the balance sheet and how you're able to fund the significant growth in GMV for these levels? Thank you.

Max R. Levchin
Founder, Chief Executive Officer & Chairman, Affirm Holdings, Inc.

A

Michael, on mute.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

That's a really good question and you saw during this most recent quarter is a pretty healthy amount of securitization volume. And for those who are attracting it, we actually did just price a securitization deal earlier this week for another $500 million in capacity. And we're doing that at a pretty significantly enhanced capital efficiencies and that really attractive funding costs.

So the capital markets remain kind of wide open to us right now and we intend to take advantage of that. While they do remain open, we don't see any real constraint on funding and feel like we're in a really strong position there. We're both adding new partners doing the securitizations and expanding the existing ones. We feel really confident on the coverage we have.

Daniel R. Perlin
Analyst, RBC Capital Markets LLC

Q

Thank you, both.

Operator: Thank you. Our next question comes from Timothy Diodo (sic) [Timothy Chiodo] with Credit Suisse. Please proceed with your question.

Timothy Chiodo
Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks a lot, Max, Michael, and Rob, for taking the questions. On Shopify as well, third one on this, but sorry to go there, but on the longer-term opportunity, maybe you can talk a little bit about the potential to expand that to higher AOV or perhaps other market or regions with Shopify. And then more tactically, if you could just recap for everyone the onboard mechanics, whether it's different for the new merchants, existing merchant, concepts around default on opt in, opt out, and really the heart of the question that I think investors are trying to get to is how much of the Shopify volume could ultimately become addressable?

Max R. Levchin
Founder, Chief Executive Officer & Chairman, Affirm Holdings, Inc.

A

It's a great question. So I definitely should not, cannot speculate about other geographies just because it is something that I think we're very focused on our market that includes both US and Canada. But that's one aspect of it. In terms of overall possible reach on shop , again I think it's probably irresponsible to speculate exactly what that number is. But a big part of what we're testing with our partners in Ottawa is exactly how easy will it be for a merchant to sign up. In other words the intent of this partnership is to make it incredibly smooth and essentially spontaneous experience for a merchant to say, oh, yes, shopping installments powered by Affirm, of course, I want to do it.

And so the intent is to get as much of the overall volume as possible that, of course, not everybody on Shopify sells low AOV items but also includes high 80 items as well. So that's – that is where we're headed. But for the moment we need to make sure that both the sign-up experience, the underwriting merchant acceptance and ultimately go live end-to-end conversion share cards are the sort of things that we're all proud of.

Timothy Chiodo
Analyst, Credit Suisse Securities (USA) LLC

Q

Excellent. All right. Thank you so much for taking the question.

Operator: Thank you. Our next question comes from Bryan Keane with Deutsche Bank. Please proceed with your question.

Bryan C. Keane
Analyst, Deutsche Bank Securities, Inc.

Q

Hi, guys, and congrats on the first quarter as a public company. I wanted to ask about the travel area, the volumes obviously came off significantly. I think you said it was only 3% in 2020. When you guys think or when you – have you modeled any kind of a spring back in that by even Q4 or is that going to be more of a fiscal year 2022 phenomenon and when does American Airlines start ramping up into there? That'll also help, I'm sure.

Max R. Levchin
Founder, Chief Executive Officer & Chairman, Affirm Holdings, Inc.

A

I'll answer qualitatively and let Michael answer to the modeling parts of it. So, Michael, start unmuting yourself now. So American, obviously, it's a very recent deal and so we're super excited about it. We think it's going to be incredibly valuable for us not to in any way disparage or diminish our existing extremely awesome partnership with Delta which has been with us for quite some time, and we've been very happy with them. [indiscernible] (00:50:14) travel industry took quite a hit in 2020. We actually invested very heavily in 2019 in building up both our feature set and our partnership set in travel, and in fact 2020 was going to be the year of travel for Affirm, except it would be the year of not travel for anyone.

And so we expect at some point it will be quite a nice tailwind for us. Obviously, our attention to the airline industry and the American deal speaks to our intent. I am probably not the right person to speculate about things like vaccine rollouts and what that really means. That said, I think I'm within bounds when I say that we are seeing increase in art and travel volume. In other words, we are seeing first signs of recovery. I'm not sure if this is a great quantitative answer in a sense that I'm not prepared to say, and here's when I think it's going to get back to normal or get back to what we all wanted to be. But I think the world is starting to wake up a little bit to the idea of getting on a plane and go to some places. And Michael will probably tell you how we're thinking about the [ph] potentials of flying forecast (00:51:22).

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah, just in terms of outlook, we don't have a particular moment in this fiscal year for it to turn on. We're pretty cautious here. We've talked about it being more of a fiscal year 2022 thing, so after the summer into the fall. Obviously we'll keep you up-to-date that if that starts to change and the [indiscernible] (00:51:44) take off, but for right now we're being pretty cautious here.

Bryan C. Keane
Analyst, Deutsche Bank Securities, Inc.

Q

Got it. And just as a follow-up, thinking about MDRs, there's some concern that maybe MDR will have to kind of go lower in the industry as the BNPL penetration increases and obviously PayPal is pushing their selves and talking a lot more about BNPL as they get into the space. So I guess the question is, Max, on overall MDRs, is it sustainable at these levels or will it be a natural phenomenon, well, as more volume comes on, maybe we'll see rates drop a little bit. Thanks.

Max R. Levchin

Founder, Chief Executive Officer & Chairman, Affirm Holdings, Inc.

A

Yeah, I think it's very difficult to prognosticate about what we expect in the future from – like obviously we think ourselves very special and we provide a service constructively unique even in a highly competitive industry like BNPL. A huge portion of what we do that others can't or don't, is our ability to address the entirety of the transaction values. And so in the low AOV space, it's a little bit less of a risk management and more of a marketing-centric component and therefore is more competitive. It's a little bit easier to be successful there versus the more complicated, more time-centric high AOV piece. And so I think we've proven over the years that we're very good at to pull those segments and we've done well there.

As a technology and data-centric company we provide a lot of value to merchant that goes well beyond will help you close the transaction, so we have data services, we now have this really rich collection of Affirm and service offerings which we're bringing to market. Ultimately we don't love competing in price. We love competing on value-added and sort of things we can do that others cannot. So I can't prognosticate about where the prices go, but I can tell you we'll continue inventing things that others don't have.

Bryan C. Keane

Analyst, Deutsche Bank Securities, Inc.

Q

Got it. Super. Thanks, guys.

Operator: Thank you. Our next question comes from Andrew Jeffrey with Truist Securities. Please proceed with your question.

Andrew Jeffrey

Analyst, Truist Securities, Inc.

Q

Hi. Good afternoon. Appreciate you taking the question. Max, maybe I'll build a little bit off Bryan's question from a competitive perspective. There are a number of players in the market. Can you elaborate on why you think Affirm wins and particularly what differentiates Affirm from peers? I mean, you're not really doing Pay in 4 per se. Today it's a much more complex model. And I wonder if you could just speak a little bit about why you think you have a competitive advantage and maybe why Affirm is uniquely positioned to take big share exclusivity with platforms like Shopify notwithstanding?

Max R. Levchin

Founder, Chief Executive Officer & Chairman, Affirm Holdings, Inc.

A

So I'm not 100% sure what you meant by we're not doing Pay in 4. I think Pay in 4 may be a trademark of PayPal's at this point. So we're not by way of not using someone else's trademark, but we very much have a [indiscernible] (00:55:04) product that we have to market under the name of split pay which competes in that very space. Ours is better because we don't charge late fees and we are much more transparent and simpler.

But that said, the sort of the idea of taking a $80 item and splitting into four repayments of $20 is something that we do in borrowing quite nicely. I do agree that there are plenty of players in the space that do this particular product. The air becomes a little bit rare if you start saying, well, what happens when you get to, let's say, $800. And that product – $800 is too much to just put in a single transaction; probably $200 every two weeks is also a little bit uncomfortable from the cash flow perspective, and that's where you end up having to do things that take 6 months, 12 months, et cetera. And we have products that span all of it from six weeks to 48 months. So in that sense we offer consumers a choice and merchants an opportunity to offer a payment plan that is quite short for low AOV items and potentially as long as four years for higher AOV.

That's one of the key advantages especially enterprise merchants where – and platforms which are [indiscernible] (00:56:24) enterprise merchants or merchant aggregators tends to want to partner with a provider that has excellence in technology which will certainly bring [indiscernible] (00:56:33) and someone who can service the totality of their customers and the totality of their products. And we are able to do all of that and we are quite good and scalable in such matters. And so those are the two endpoints of why we've been selected by Shopify, why Rakuten, why other partners in the space have consistently chosen us.

The other one which I feel never gets enough fair play and so I'll just keep on repeating it, we're the only ones in the space that actually speaks to the end consumer truthfully. We don't charge late fees, we don't do it for interest, we don't do any of the things that ultimately spurs somewhere between rolling their eyes at and just get very, very angry about. And consumer brand love is important to us and it's very important to merchants which fundamentally what drives repeat transaction. So we are very keen on continuing down that line as well because ultimately merchants and merchant platforms want to partner with brands that add to their own brand love as opposed to potentially embarrass them. And that's something that we feel very strongly about and we continue to wish the industry would change and follow our lead. But for the moment we are unique in that sense and we take great pride in that, just continue winning deals because of that point of view.

Andrew Jeffrey
Analyst, Truist Securities, Inc.

Q

Okay. That is helpful. Helpful point of extinction from you. And then, Michael, just on the guidance, I wonder if you could offer a color here that 3Q GMV is projected to level [indiscernible] (58:09)?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

I think that the biggest thing to think about in Q3 is the Peloton capital issue we talked about in the prepared remarks where we are seeing and we're seeing that take route. Ex-Peloton we're seeing material acceleration. It's all material acceleration in Q2 and we're projecting even more acceleration ex-Peloton in Q3. So, overall very good consumer demand, with Peloton extremely strong, but the timing of the recognition of that GMV is going to be a function of when those orders ship.

Andrew Jeffrey
Analyst, Truist Securities, Inc.

Q

Thanks. Appreciate it.

Operator: Thank you. Our last question comes from Chris Brendler with Seaport Global. Please proceed with your question.

Chris Brendler
Analyst, Seaport Global Holdings LLC

Q

Hi. Thanks and good afternoon and congratulations again. I'd like to talk about ready to – sort of the competitive environment from a sort of different perspective. Do you think it's a little bit of a land grab right now with buy-now-pay-later really taking off here in the US and around the world? So my two questions on that front are, do you see any impact or do you see any instances where there's more than one provider and how does Affirm sort of market share at the point of sale hold up when there is more than one provider?

And then my second question, more of a strategic question is, this Shopify deal seems super exciting and has a lot of potential. Do you expect to do more of these sort of megadeals where you're providing a little bit equity incentives, or is this kind of the one you're going to stake a claim in near term? Like how are you thinking about these large marketplace transactions where there's a lot of volume, but potentially some equity cost as well? Thanks.

Max R. Levchin
Founder, Chief Executive Officer & Chairman, Affirm Holdings, Inc.

A

Great questions. So on the former, I think history is always a good predictor of the path. And we'll do a first round of payment network creation ultimately settled with three or four brands that are universally recognized depending on whether you include Discover or not, but Visa, Mastercard, AMEX are certainly more or less on every checkout at this point. So I think the expectation should be that there will be more than one BNPL brand that wins. And the reality is we're all – yeah, land grab [indiscernible] (01:00:36) especially positive, but I'd like to believe we're all peeking over parts of the credit card volume, and that is an enormous chunk of transaction volume, and there's quite a lot of growth for everyone.

Obviously we're biased in our favor but [indiscernible] (01:00:52), I do expect to have multiple players at at least some of the checkout. Some of the deals that we signed are exclusive, some of the deals are not. In some cases we are added two interesting provider [indiscernible] (01:01:04) our worth by doing better then. So I think overall we are happy with how that is developing. The question...

Chris Brendler
Analyst, Seaport Global Holdings LLC

Q

Another Shopify?

Max R. Levchin
Founder, Chief Executive Officer & Chairman, Affirm Holdings, Inc.

A

I'm sorry. I threw my notes, busy with the first time. So the Shopify question is a good one. Two-part answer in very short form is we would love to do more megadeals. I think the structure of those deals are by definition unique and special. And so any form of speculation of what exactly what it would take to sign another Shopify is probably beyond the scope of this conversation. But that said, we are – again if I do say so myself, the perfect provider for these very, very large platforms specifically because we have this enormous advantage in data and technology at a proven scalable and robust.

And so fundamentally I don't think offering someone a chunk of your company if a mega partner doesn't believe you'll be able to withstand their mega volume, [indiscernible] (01:02:21). So the equity piece is not a reason a company selects a partner, it's because we're actually good at what we do and we can take on [indiscernible] (01:02:31).

Chris Brendler
Analyst, Seaport Global Holdings LLC

Q

Great. Thanks so much. Appreciate it.

Max R. Levchin
Founder, Chief Executive Officer & Chairman, Affirm Holdings, Inc.

A

Thank you.

Operator: There are no further questions at this time. I would like to turn the floor back over to Michael Linford for any closing comments.

Michael Linford

Chief Financial Officer, Affirm Holdings, Inc.

Thanks, everybody, for joining on our call and we look forward to seeing you guys next quarter. Thank you.

Operator: This concludes today's call. You may disconnect your lines at this time. Thank you for your participation. Have a wonderful evening.