Affirm Holdings, Inc. NasdaqGS:AFRM

Company Conference Presentation

Wednesday, November 29, 2023 7:55 PM GMT

Table of Contents

Call Participants 3

Presentation 4

Question and Answer 5

Call Participants

EXECUTIVES

Michael A. Linford
Chief Financial Officer

ANALYSTS

Jill Elizabeth Glaser Shea
UBS Investment Bank, Research Division

Timothy Chiodo
UBS Investment Bank, Research Division

Presentation

Timothy Chiodo
UBS Investment Bank, Research Division

Great. Welcome, everyone, to the afternoon session here at the second day of the 27th Annual Global Technology Conference. We're very fortunate to have with us today the CFO of Affirm, Michael Linford with us, but I also want to take a moment to acknowledge and introduce my colleague, Jill Shea, who is a co-covering analyst on Affirm and has joined our team. So Jill and Michael, thank you for being here today.

Michael A. Linford
Chief Financial Officer

Thank you for having me.

Question and Answer

Timothy Chiodo
UBS Investment Bank, Research Division

All right. Great. We have a good lineup of questions that Jill and I will walk through together and then it looks like we'll hopefully have some time for Q&A from the audience at the end.

So let's try and get at it. So we're just coming out of the Investor Day, right? So lots of new information in the market around Affirm, lots of good numbers and a lot of investors to digest. In terms of the medium-term outlook, I think you summarized it pretty well, Michael, at the Investor Day when you basically said, not a lot changed, right?

So RLTC, the key metric that we often discuss with investors, you kept it at that 3% to 4% and you gave some scenarios around how we should think about your margins relative to growth hovering around the greater than 20% or less than 20% range. So with that, maybe you could add some additional context?

Michael A. Linford
Chief Financial Officer

Yes. I mean we thought it was important to remind folks that as far as we're concerned, the business is still very much on track. The macroeconomic volatility over the past 12 to 18 months has been very real. And yet, the fundamentals in our business really haven't changed, and we continue to expect 3% to 4% unit economics.

We continue to expect to be able to drive operating leverage. So one tweak we did make to the model is we're now signing up for a modest level of adjusted operating income in that more growth full period. And that's just a reflection of how the business is being run today.

You saw pretty strong performance in our first quarter where we posted around a 12% adjusted operating margin. That's a really healthy number, probably even too healthy, but an acknowledgment of just what happens when we apply a little bit of operating leverage to this business.

It's a business that is so complicated and has so many parts to it. But at its core, we write software that solves financial product problems. And because of that approach, you can create a lot of operating leverage very, very quickly by simply not adding even capital, which is what we've done over the past couple of quarters.

Timothy Chiodo
UBS Investment Bank, Research Division

Nice. A brief follow-up before passing to Jill. The -- in that 3% to 4%, which you didn't change, could you just talk a little bit about some of the maybe just directional assumptions that you might have had for contributions from some of the lower RLTC products, either it be Pay Now or Pay in 4?

Michael A. Linford
Chief Financial Officer

Yes. So Pay Now today is pretty much exclusively inside the card. And we showed some stats at the investor forum and talk a lot about it being -- we're impressed with how many transactions are flowing through Pay Now, but it's not a material part of the GMV yet.

And it probably won't be into the future. And frankly, we would consider that to be a really good thing if it changed. In other words, we welcome the opportunity to come to the market and explain why we had so much Pay Now performance, low risk, high margin on a percentage basis, products that we could have to explain a lower GMV take rate there.

So we're not worried about that problem. In fact, we're actively trying to create it. But remember, most Pay Now modalities are lower ticket size. So you cup of coffee, your donut are going to be in the single-digit dollar ranges and your couches or bicycles are going to be hundreds of dollars. And so there's just a natural trend in our product that brings you to Pay in 4 things over time that cost more.

And so you're always going to see a GMV weight, we think, towards that. And that's reflected in our 3% to 4%. In terms of Pay in 4, today, we have a robust Pay in 4 business through Shopify. We have a business outside of Shopify too. We continue to want to serve that particular transaction type, but we're doing it today with our adaptive checkout product that allows us to really dial in the level of economics that we need to get out of a transaction and serve up the right financial product.

It probably doesn't make sense to divide a $2,000 ticket into 4, if you can’t afford $2,000, you probably can’t afford $500. And equally, it doesn't make sense to take a $50 purchase and spread it over 12 months. So our adaptive checkout product allows us to serve the right product that kind of matches our need for economics with the consumer product that actually makes sense.

Timothy Chiodo
UBS Investment Bank, Research Division

Thank you, and over to you, Jill.

Jill Elizabeth Glaser Shea
UBS Investment Bank, Research Division

Great. Thank you. So at your Investor Day, you provided details on your 3 growth pillars, 1 of which was scaling the Affirm card. The card has scaled nicely with greater than 500,000 active consumers in October and $100 million in monthly GMV. We appreciate all the details that you talked about at the Investor Day. Perhaps can you touch on what the continued rollout looks like, when do you see an inflection point in adoption? And how do you expect to maximize penetration of the 17 million active Affirm users?

Michael A. Linford
Chief Financial Officer

We continue to be just ridiculously excited about this product. I'm actually wearing a piece of now vintage gear -- the product was named Debit+ originally. I'm wearing it. It's my favorite piece of Affirm gear -- it's my favorite product at Affirm right now. I really believe that the best Affirm experience is one that removes as many barriers and friction points for the consumer and the card does that.

The reason why the adoption has been like it is, is because it really is the best way to use Affirm. And there's a lot of work that we need to do to continue to make it good and better in terms of that overall user experience. But the most important thing we do is we give the purchasing power to a consumer in a tender type that they're used to using a piece of plastic. It goes anywhere, it's very familiar to them and doesn't require a lot of work in an app, blocking up the checkout lane at the grocery store.

And so we're really excited about the product. The rollout continues to be targeted at our existing users as they repeat. So for those Affirm users in the audience, I suggest pulling out your app and taking a peak at the card tab. You can still take out a onetime use virtual credit card to go do an Affirm loan anywhere, but you can also apply for and get a persistent card number.

And that's a process that we continue to expect users to find very naturally. We're not out spending a bunch of acquisition dollars, marketing dollars to acquire users. We're letting users find it and reminding them that they have the ability to do that.

And then encourage them to continue to get more of the experience. We have a very big business today, engaging our repeat consumers inside of our app. The way in which we ask them to do that when it's an integrated merchant is very seamless. They pop out, they go to an integrated merchant site, and it's a great experience.

The way we ask them to do it when it's a nonintegrated merchant is there's lots of hoops to jump through. You have to actually move over the 16 to Japan. You have to move over the CIB, the security code, the expiration date. And then there's a lot.

And the card when you get the persistent card, it becomes a lot easier because it becomes your number. It's even better when you get the physical card behind it, and it's even better than that when you go ahead and link your banking account to the card, so you can get access to the Pay Now functionality. And then the best experience, at least in my opinion, is when you go all the way to the Affirm money account, which we talked about at the investor forum, which allows users to actually store their spend account dollars in an account with us and allows us to extend purchasing power that matches the amount that's there, which I think is really awesome because it gives them certainty with what their purchasing power is and that's really one of the killer features of Affirm as we give you the confidence to know that your transaction can be done.

Timothy Chiodo
UBS Investment Bank, Research Division

Thank you. All right. Let's talk a little bit about the unit economics of Affirm card. So one of the big surprises was that you essentially been delivering, and you've guided the Affirm card to be in that same sort of 3% to 4% range, just like the rest of the business. And the surprise there was related to the mix of the volumes that were being ported over to the installment portion or the loan portion, the interest-bearing loans.

So I think with that context, let's talk about the ways that Affirm makes money, some of the revenue and the cost. So the big components are interchange. There's the interest income and then there's also a smaller component that maybe you could dig into in terms of some of the affiliate or lead gen type of fees. And then we'll circle back and talk about the NSF portion on the cost.

Michael A. Linford
Chief Financial Officer

Yes. So for the card today, those are the right buckets. I think one of the things that we're excited about with the card is also earning integrated merchant fee levels for things like Pay in 4 and 0% promotions for merchants who do want to be able to market those offers to consumers, especially in store.

In store, I think, remains a problem that largely hasn't been solved for anybody. And I think the exciting thing about the card is there's very little on the way now of us being able to market to users the ability to pay over time and pay over time even with attractive 0% offers in the store as soon as you actually have a card.

And so that's an additional piece. But even before you get there, we do earn today merchant fees for referring consumers to certain transactions, the transactions starting our app, of course, it's not our -- the bulk of our business. We always like to say that we're focused on making sure that the financial product makes sense.

But it is a good way for us to access other revenue sources like we do with any other program that allows us to offer different products to the consumer or improve deeper.

Timothy Chiodo
UBS Investment Bank, Research Division

Excellent. So those are great on the revenue sources, interest income being likely the largest. Let's talk about the cost. So when a loan is being repaid or when even funds for a Pay Now transaction are being brought over, it's done through ACH. And let's just talk about how you've done sort of build out a capability to control those NSF costs?

Michael A. Linford
Chief Financial Officer

Yes. It was a real focus for us early. The ACH is a less expensive way to process repayment. It's pretty much required at a certain low enough average order value. There's fixed components to debit processing that make it very prohibitive to process repayment for small transaction sizes. And so a linked bank account, which is what we use to process ACH payments, was really a critical part of the ability to do pay now from the outset.

And that was a whole new piece of risk management that we had to build, a whole new muscle we had to build. One of the things that we talk a lot about is that everything in payments is a risk product, it's varying levels of risk. It's instantaneous risk if you're moving money very quickly or very long-dated risk if you're taking longer loans, but it's all just risk management and the risk management piece that we really had to get a hold of was making sure that we had models that could predict the probability that the consumer actually had the funds and then flows to cure that as quickly as possible if they didn't.

And that continues to be an area that we're going to be focused on because that definitely informs the level which we're comfortable with consumers paying now, right? So if you think about our product, it's Pay Now or it's pay over time. The pay over time has 2 modalities, ones post, but we prefer the pre-approval modality. So it's a consumer walks into a transaction, communicates to us their intent, gets their approval and agree to terms before they check out.

It's a pretty magical experience. When you think about it, you go through this loan application, you agree to the lending, and it just sits out there. You swipe the card. And then behind the scenes, we collect the 2 and then it doesn't hit your account, it goes to a loan account.

It's pretty often, we can do that. And that modality is great because we're underwriting that specific transaction ahead of time. So we're thoughtful about it like we are in everything else we do, which is why the economics are consistent with the portfolio.

But the pay now modality, we don't have that. You are limited today in what you can Pay Now with in our models to help inform what that limit is. And of course, we'd like to be as unlimited as possible. It's still healthy and good for the consumer. And so the better we have to get on understanding what the consumers' real-time capacity is, the better we're able to do that.

And again, why I'm so excited about the Affirm money account is for the users who want this to be their top of wallet card for the users who get all the way to the end of that journey, their spend limit is governed by the actual funds in the account, which is a pretty cool feature and gives them a lot of confidence and control over what they can buy.

Jill Elizabeth Glaser Shea
UBS Investment Bank, Research Division

Great. So just turning to the Affirm money accounts, which have the transaction account capabilities, can you just dive into the features there and how that creates a tighter experience for the user?

Michael A. Linford
Chief Financial Officer

Yes, we've had a savings account live on Affirm now going back to several years, 3 years, I think. And the product has always been thought about as a good way to continue to engage users, but really nothing more. It hadn't been connected to the rest of the ecosystem.

And we're doing more work to connect it and the Affirm Money account is a good example of connecting that same infrastructure to a spending account. So the account that I use, my team told me I'm the #1 by transaction user of the product.

So I give them lots of feedback about how it does and doesn't work. But what's really powerful about it is you have complete certainty in your Pay Now capacity, it's the amount of funds you have in the account. You're in a healthy APY on that, which is something that a lot of folks aren't getting on their demand accounts.

You're earning a healthy APY on the balance as you do store, you have complete control over the amount. And then you can still do all of the purchasing power enhancement stuff that we do by getting loans, both before and after the swipe.

Jill Elizabeth Glaser Shea
UBS Investment Bank, Research Division

Great. And perhaps now we can shift to the B2B opportunity, which you talked a lot about at Investor Day. We know the company is in early days here. You launched Amazon on November 2, and you recently announced the Best Buy for business. at the Investor Day. We wanted to see if you could talk a little bit more about what these loans look like at this early stage, just range of terms, approval reads, just any color you can provide there?

Michael A. Linford
Chief Financial Officer

Yes. I think the best way to think about this is -- it's just more of what we do every day for consumers, for folks who are running sole props. There's any number -- it's really important to ground people, and we talk about B2B the kind of businesses that we're talking about.

I got a question, a well-intended question for investor earlier today is like ask me about these businesses procurement teams and I had to stifle my laugh. These businesses don't have procurement teams. They don't have teams. They are individuals. They're individuals running really small businesses, very main street stuff.

Think of -- so I want to run a little CPA shop and they have a couple of accountants and they're buying snacks. But they buy them in bulk, and they're paying $200 for that or you run a business laying Ethernet cable for houses in the neighborhood, and you need to go buy a couple of hundred yards of cable from Best Buy. These are purchase modalities that today, those folks who don't have procurement teams, they're not big businesses. They don't have lines for the business.

Their choice is really to use other consumer financial products like credit card and oftentimes their personal credit cards and not take benefit of the same things that we do for consumers. And so we're extending what we do for consumers to those purchase types, which means we expect the loans to look a lot and perform a lot like the kind of assets that we're creating on the consumer side.

Jill Elizabeth Glaser Shea
UBS Investment Bank, Research Division

Okay. So maybe just digging in a little bit there, just given the characteristics of the sole prop, can you talk about the underwriting considerations there versus the consumer transactions and does this translate to different yields versus what we would see on the consumer side?

Michael A. Linford
Chief Financial Officer

No, it really shouldn't translate to different yields and it should be very, very similar. So we're -- part of the reason we're starting there is that problem looks more like a consumer underwritten loan than most business loans. And so we don't have to invent a whole new way of thinking about the risk there, we can think about it in a really similar way to the way you think about the consumer risk.

Jill Elizabeth Glaser Shea
UBS Investment Bank, Research Division

Okay. Fair.

Timothy Chiodo
UBS Investment Bank, Research Division

All right. Let's move to Amazon and Shopify. Okay. So Amazon, a little bit less than 20% of GMV. We think combined, these 2 are sort of in the 30% to 35% range, but that's the today. So if there's any clarification you'd like to make there. But let's talk a little bit more about the tomorrow and some of the opportunities to grow with these 2 platforms, Shopify International being one of the more recent highlights.

Michael A. Linford
Chief Financial Officer

Yes. I think, look, we're still very early in the categories of rollout overall. I think that you heard in the investor forum, we've got a really great partnership with Shopify. The anecdote around this idea that the teams are gelling so that you really can't distinguish the 2 is, I think, really powerful because it really is a product that both of us want to see and see successful. .

And therefore, I think that we continue to be really excited about all of the future there, whether that's international, whether that's other ways to serve and frankly, other products that we can deliver to the Shopify merchant base. We can also help Shopify payments grow as well and Shop Pay grow. And I think those are -- those things look together and why we're excited about and they're awesome partners.

They really have, I think, written the playbook for how to build good, deep durable partnerships. And I think with respect to our largest enterprise merchants, they're just so big that the total market there is like bigger than most countries. And so for us, it's so big and so massive that the list of to do the amount of work we have to fully realize the benefit is very, very long.

I know that's the thing we've said a lot. It was met with a lot of skepticism, I think, from some folks. But the proof with Shopify as an example, that business is accelerating now 3 years into the relationship, and it's accelerating right now. And I think that's a testament to the fact that what we do is pretty complicated, and there's a lot of work to do, it's not just flipping the switch.

And that's certainly true with our largest enterprise partners. We feel like there's plenty of work to do to continue to get a higher share there. You think about where those businesses should be, those businesses together are somewhere between 35% and 45% of U.S. e-commerce, and that's where we would expect our share to be there.

We think we're underpenetrated there versus the rest of our business.

Timothy Chiodo
UBS Investment Bank, Research Division

Thank you. So you referenced a little bit there was Shop Pay. So the Shop Pay button, more of a mechanical clarifier here, as the Shop Pay button moves off the Shopify platform, which they've announced and its live and active as we speak. Does Affirm's offering within Shop Pay travel off the Shopify platform as well, expanding your opportunity with theirs?

Michael A. Linford
Chief Financial Officer

Maybe just a more broad answer here. Wayne talked a lot at the Investor Forum about buttons and wallets as being an important distribution point for us. And in our willingness to embrace the potential channel conflict that may come out of that. There are merchants today where you can use Affirm directly integrated. You can also find Affirm in a button, you can find Affirm within our app and take out a virtual card. And like that's 3 or 4 different ways to use Affirm with that merchant, and we're totally comfortable with that, because we're so early in the adoption.

And so we're not particularly fussy about the 5 bps difference you might see across the different payment types. So we'd be delighted to go with shop wherever they would take us the -- today, the product is on Shopify and we'd be excited to go everywhere with them, just as we're excited to work with Amazon Pay and their button and any other wallet and button as well.

Jill Elizabeth Glaser Shea
UBS Investment Bank, Research Division

Great. So perhaps we can shift to funding. So you've made a tremendous stride scaling your funding ecosystem over the last several years and well ahead of your GMV growth with 3 primary channels with ABS, forward flow, or loan sales and warehouse lines. Can you just talk about how you optimize across those channels and how diversification across the channel supports and enables your growth?

Michael A. Linford
Chief Financial Officer

Yes. I think the last point is really important. Brooks spent a lot of time on that at the investor forum. Diversity of funding partners is something that's really important to us. And it's important to us because if you're negotiating with or managing through volatility with the same kind of capital at the table, then you have the same conversation 10 times and you don't get to have any sort of flexibility or durability through the cycle.

And that diversity has served us very well. We have been pretty insistent that we're going to continue to grow all 3 channels. One isn't better than the other. We know we have a need for warehouse financing on the balance sheet. We'll continue to use that.

We know that the ABS market is very deep and big and constructive to us. And we know that whole loan sales are the most capital efficient thing we can do. And so we are going to continue to grow all 3 parts of that business and more. And the optimization is like, I think, probably the third thing we focus on.

The first thing we focus on is making sure we enable the growth in the business. And I appreciate you calling it out. The capital team has done a phenomenal job in making sure that they accomplish that goal. We can fund the business and have been able to fund the business as it scales. And that remains job #1.

The second priority for the capital program is to make sure we're delivering the right unit economics. Clearly, if a particular funding channel gets very expensive, if the yields in the forward flow market get really high or the ABS costs flow out, it becomes difficult for us to deliver our unit economics.

And so you just think about making sure that we can fund the business and fund the business consistent with the 3% to 4% we've talked about. And then the last priority is to make sure that we're capital efficient that we're mindful about the amount of equity we have going to that part of the balance sheet. And that's -- those 3 goals are in that order on purpose. We've got to enable the growth first.

And so we don't sit around and think about, let's only add this kind of capital because we like it more right now. We think of it as we're going to grow from at least $24.25 billion of GMV this year to $50 billion over some time period. And we're focused on how we're enabling that next quantum of scale.

And so to do that, you really do have to execute across all channels. We've been very active in the ABS market today. You should expect us to be active very soon as well. And we're going to continue to be active in accessing any and all funding channels.

Jill Elizabeth Glaser Shea
UBS Investment Bank, Research Division

And then just shifting to the asset side of the balance sheet and yields. In the shareholder letter, you plotted the yield for your assets versus your funding costs, and there's a pretty big inflection on Affirm asset yields reflecting some of your pricing initiatives. And through the month of October, more than 90% of the interest-bearing GMV was offered at the max APR of 36%. Can you just walk us through the interest income dynamics as it relates to asset yields and what that tailwind looks like over the near term?

Michael A. Linford
Chief Financial Officer

Yes, I would definitely encourage everybody to take a look at that chart. What's really important is that, that 90% stat, we got to in October. It really wasn't even the high in fiscal Q1. And so we incrementally unlocked more GMV that could be underwritten up to 36% in October. And we got to a number that we feel good about. We've always said like 100% will probably never happen. We've got to 90%, we'll probably stop talking about that as a number now.

But what's interesting about that is you saw the lag from when we were able to get those 36% cap starting to move earlier this calendar year. You didn't see it show up in the asset yield really until last quarter, a quarter before last and then materially in Q1. And that, again, wasn't reflecting the whole portfolio there.

So we feel like there's continued upside here from the pricing initiatives rolling through. Upside, which we intend to reinvest. I mean we continue to want to be able to offer products to consumers that have the highest end-to-end conversion, that delight consumers the most and get them the most engaged. And so we don't think that's a chance to out earn, we think it is a chance to be focusing on scaling the network, which is where we wanted to be.

And coming back to the very first question, why I think we really like our position right now is we did a lot of work last year to retool the business, got the asset yields back where they needed to be in this new rate environment. And we're pretty comfortable if things stay in this environment, we can continue to deliver on what we've always said we wanted to do.

Jill Elizabeth Glaser Shea
UBS Investment Bank, Research Division

Great. And then just maybe touching on credit quality really quickly and the health of the consumer. You stressed that underwriting is of utmost importance to you and you carefully watch all the metrics. Can you just tell us what you're seeing as it relates to the health of the consumer currently? And what's your expectation over the near term?

Michael A. Linford
Chief Financial Officer

Yes. I mean I think the consumer still very employed and very active in commerce and out spending. And so we think that's good things for us. The employee consumer is a very good thing for us. And that's the most important thing, much more important than rates with respect to the consumer. And so we still feel like they're in a strong position. Our credit performance continues to be in line with expectations. And I think you're seeing the advantages that we have in underwriting and the advantage we have in being a transaction level approver really separating us from many others.

And I think a lot of the traction we've had in the capital markets is the feedback loop of really focused and disciplined control of credit outcomes, showing up in the asset, allowing capital partners to get more attractive to the asset, allowing us to do more of it. And that loop works -- the feedback loop works very well when things are working. And then when you have these kind of exogenous factors come in like a rate shock, you do have to retool a little bit, but we feel like that loop or flywheel is back to working really well right now.

Timothy Chiodo
UBS Investment Bank, Research Division

Okay. Thank you. I think we can get 1 question in from the audience. If anyone would like to raise their hand, we could take a question. Okay. If not, we'll squeeze in one last one. We can do this quick. I think we can do it. So the processing cost line, right? So there's some components there, right? There's repayment mix. And to the extent you could give us an update on what that repayment mix looks like. But the Affirm money count might be something that could help improve that cost. And then -- the other offset to consider there is that the Shopify business continues to grow, the portion of their revenue share is put into that line item. So some puts and some takes.

Michael A. Linford
Chief Financial Officer

Yes. So a lot of the growth in that line has been the platform fees that we pay. And so it's not actually our cost to process as much as it is our cost to access the system. And a lot of the growth has come from that. That being said, it remains an opportunity for us. You have pointed this out several times correctly that there's a pretty material cost difference. And we talked about it with Debit+ specifically, but more broadly, one of the things that limits our ability to go down a certain average order values is the fixed portion of debit repayment costs. And so you can really open up more transaction types and modes, which is very important when you think about the vision that Max laid out, we want to be able to serve some -- to mean something to every transaction type. And today, we're somewhat constrained on those repayment modes.

Things like Affirm money account, but also just better linkages to people's checking accounts allow us to rely on less expensive payment reprocessing. But there's also other work we can do. As our repeat rates go up, we can also do work to more intelligently process payments in a way that may and do some of those fixed components out.

So there's a lot of work to do there. And it remains, I think, a pretty big opportunity for us. All that being said, we'll never get in the way of consumers trying to pay us back, right? The thing that we're really careful to do in all of these payment processing improvements is to never do anything that diminishes consumer repayment because the credit signal is obviously a lot more valuable than the payment reprocessing costs.

Timothy Chiodo
UBS Investment Bank, Research Division

Excellent. Well, that brings us to a close on behalf of our full team here at UBS and especially on behalf of Jill, who recently joined us here covering Affirm, we want to thank you, Michael, for making the trip here to Arizona. It's been a pleasure hosting you.

Michael A. Linford
Chief Financial Officer

Thanks for having me.