Corrected Transcript

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Affirm Holdings, Inc. (AFRM)

Investor Meeting - Barclays

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CORPORATE PARTICIPANTS

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

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Ramsey El-Assal
Analyst, Barclays Capital, Inc.

MANAGEMENT DISCUSSION SECTION

Ramsey El-Assal

Analyst, Barclays Capital, Inc.

Welcome, everyone. Thanks for joining us today. My name is Ramsey El-Assal, and I cover fintech and equity research at Barclays. And I'm very pleased to be joined today by Michael Linford, CFO of Affirm, for a fireside chat. Michael, thanks so much for being here. Appreciate it.

Michael Linford

Chief Financial Officer, Affirm Holdings, Inc.

Thanks, Ramsey. It's great to be here with you and to answer the questions that are on the minds of our investors. We're pleased to provide a voice to our retail shareholders, and we've had several questions submitted that we'll get to today through the Say Technologies platform. Here at Affirm, we're committed to engaging with all of our stakeholders on our business, our strategy, and most importantly, our mission.

So with that, Ramsey, why don't you please queue up the top voted question?

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QUESTION AND ANSWER SECTION

Ramsey El-Assal
Analyst, Barclays Capital, Inc.

Q

Okay. The first question comes from retail investor, [ph] Joshua F. (00:00:51), who asks the following. Do you expect Affirm to be profitable the rest of the year, and what is the outlook for 2023?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Thanks for the question. First, and this is really important, we measure profitability using our adjusted operating income measure. And what that does from GAAP net income is adjust out a few items including stock-based compensation which is obviously volatile, as well as CapEx and even the amortization of some warrant grants that we've done. We think this number is most closely related to cash flow, which we believe is the right way to think about this business in the long run.

Fiscal 2022, which ends in June 30, was definitely – is definitely an investment year for Affirm. Fiscal 2021 was marginally profitable on an adjusted operating income basis. But fiscal 2022, we've guided the market to expect a loss rate in the – originally in the negative 11% to 13% percent range. The reason for this is that we are investing for future growth. We've laid out in the September investor forum, our framework with managing our profitability. That is, while we're in hyper growth, we're really focused on scaling the network because we believe that creates the most shareholder value in the long run. And to that end, in our fiscal Q2 we saw some really incredible numbers.

Active consumers grew 150%, active merchants grew 2,000% and our GMV was up 115%, while revenue up 77%. These kind of hyper growth periods need investment, and that investment for us is engineers and software engineers to write code. Importantly, moving away from adjusted operating income, we measure the economics of our transactions using a measure we call revenue less transaction cost. This is the amount of value that we get whenever we let consumers borrow money and this is really important. I think it's a mistake to confuse the profitability of the bottom line of the enterprise, which is weighed down by our investment in things like engineers with the profitability of the lending that we do, which is actually really strong. So our revenue less transaction costs, for example, in Q2 grew 93% and we feel really good about the continued growth in the profitability of the lending that we're doing while we invest in the business for the long term.

Our plan is to continue to scale the network and we've not given any guidance yet for fiscal 2023, but we'll talk to the market in September and give you a full detail. We do expect, though, that even as we continue to invest that we'll begin to show some leverage against adjusted operating income.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.

Q

Okay. On that point, earlier this week, the company – you guys shared an update about the performance of the business and raised guidance. What's driving the stronger-than-expected performance? Why did you decide to raise the outlook?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

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Yeah. First and most importantly, we really wanted to dispel a myth, an inaccurate rumor about our business and our business performance. I think in these uncertain times folks are on edge, and we really wanted the market to hear a loud signal that we are quite confident in both the near-term and long-term prospects for our business. And so, we updated the market. The first thing we did is, is told the market that we were going to exceed our high-end of the range for this quarter that we're currently in, that ends in a few weeks, across all the measures, except for our margins, our revenue less transaction costs, where we actually told the market we would exceed $5 million above the range that we had given before.

This upside is just due to the strong traction in the business and as we highlighted in our 8-K in particular, more efficiency in our transaction costs and importantly, better-than-expected credit outcomes. And the latter one is the most important. And I think a lot of folks are very concerned about the future of the credit environment, there's a lot of macro uncertainty, and we really wanted the market to understand that our credit outcomes right now are right where we want them to be and in fact, better than we thought even a month ago.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.

Q

Okay. I'd like to ask another one about the outlook. You significantly exceeded your outlook for the second quarter on all measures that you guide. The stock's traded off, which we believe in addition to a difficult trading environment for high-growth stocks, has been in part related to raising your fiscal year outlook for both GMV and revenue really meaningfully, but without much of that upside flying through to your contribution margin, otherwise known as revenue less transaction costs.

So, how much of that profit impact was due to the ramping of new programs at Amazon and Shopify? How do you expect those programs to impact margins as we move forward here?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. It's a great question. Let me start by saying that we're extremely bullish on our strategy to attract the top enterprise merchants and platforms by having the best technology in the industry and the most pro-consumer orientation around. Today, Affirm partners with enterprises that cover over 60% of dollars spent online in the United States. That is a staggering statistic. These partnerships are a key driver of growth. You think about our success in scaling merchant counts and users last quarter was because of these partnerships. And like everything we do, we're very disciplined in how we build and scale these partnerships.

So, unlike some of our competitors in the BNPL space, we don't subscribe to the idea that you should sign in profitable deals and try to make it up in volume. In our business, it's really important that your units are positive, that you make money in the business of lending it out and we're quite disciplined on that, again, as measured through that RLTC line.

There are some challenging dynamics going on though in the business. As you scale, any relationship, you do have some start-up costs associated with learning around how to best deliver that margin profile that you want and that can create a little bit of pressure in the near term. There's also this impact that we've talked a lot about with the market around just the pure timing and flow-through of some of those measures.

So, for example, when we originate – when our partner originates an interest bearing loan and we buy it back and leave it on our balance sheet, the timing of the revenue is not matched with the timing of most of the costs, which include the provision for credit losses. And so you have this timing mismatch as you scale interest bearing

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programs. And then what's really important is, we saw a lot of success in traction on the interest bearing business in our fiscal Q2 with merchants like Walmart, but also enterprises like Amazon.

And so, that success in scale will create a little bit of timing mismatch, but, we're really confident in the long term prospects here. Again, part of the reason we wanted to signal to the market in our updated guidance here is just that we're actually continuing to be on the higher end of the range that we've given long term, for what we call revenue less transaction costs. When you measure that as a percentage of GMV, we've communicated to the market repeatedly that we expect that number to be somewhere between 3% and 4% of GMV in the long run. And if you look at our most recent guide, it kind of implies we're in the – right at the high end of that range.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.

Q

I want to – I have another question on the outlook actually. But first, I wanted to ask you about some news reports recently that Affirm temporarily put a refinancing of an ABS or an asset-backed securitization on hold. Since then, we've also seen some other companies, I think Tesla and others, delaying ABS as well. Can you talk about Affirm's funding model? And I guess, for our listeners, can you briefly touch on the difference between the debt you use to fund the loans you provide to consumers, funding debt, and the company's own corporate debt? Even to make the question a little bit more complex, how do you plan to utilize each of the three different programs within your funding model going forward?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

That's such a great question. I think even the most sophisticated investors can sometimes not really [ph] grasp that (00:08:54) because a lot of us who are used to investing through the use of like the screens you see, sometimes the data that flashes doesn't really make sense because our business is very unique. So, first, let me speak to the ABS market as it sits right now.

It's our view that when a company decides to not proceed with a transaction like that, it's because they don't need it. And if you look at the players who are choosing to defer a deal, it's because they have a lot of strength. And in the case of Affirm, that's especially true. So, we fund the business with three different funding modes. We have warehouse lines on the balance sheet, we have our securitization program, the ABS market, and we have forward flow agreements where we sell whole loans to individual counterparts, so-called bilateral deals.

Well, the ABS market is the most directly exposed to the conditions of the market, and those investors are positioned usually to price [ph] uncertainty at its premium (00:09:55). And so, a lot of companies like ours right now who decide that this is not the best time to price a deal are doing so because they don't need it. It's our view that companies who need to do a transaction right now are forcing it through bad economics that probably means they're paying a premium for this volatility. We don't feel like we need to because we have better funding opportunities away.

What's really important, though, is we could have transacted, we believe and could have done so at margins that were great for the business. But that would be silly to do in a world where you have better opportunities to fund the business with forward flow or bilateral agreements. We remain very confident in the ABS market for us in the – over the medium-term and we're committed to continuing to issue across all of our programs. When we talk to the ABS investors, it's quite stark, the difference between how an ABS investor, these people who buy these kind of securitizations, how they view our decision versus, I think, some of the equity market reaction. There's just a big disconnect.

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I think the right read of it is that companies who choose to defer a deal are doing so because they have strength and that's exactly what happened with us. Thinking about the balance sheet, we talk a lot about our funding debt. The funding debt is either the debt that we draw against these warehouse lines or the debt that sits inside of these securitizations. We call them notes issued to the trust – you can look on the balance sheet. What's really important is if you're trying to compare us to, say, a normal Internet company, you can't confuse our corporate debt, which factors into the enterprise value calculation with these kind of asset-backed debt vehicles.

And the reason why we break them down on the balance sheet for folks is to be able to separate the two. And let me just think about that for a second more. When you think about valuing a company, it's what I think about valuing a company, you like to take the total enterprise value and understand how much is in equity and how much is in debt. And so your market cap plus your net debt usually equals your enterprise value. And when we say net debt, we usually take the gross debt and back out the cash. And so if you have more cash than debt, your net debt is negative. And if you have more debt than cash, then that factors into your calculation. And this is just to say that obviously, the debt is part of the capitalization of the company.

What's really important is, all of the debt we have for our funding isn't part of the capitalization of the business. It's backed by these specific assets put in these very specific facilities. And so think about that debt as part of the business of doing lending as opposed to part of the enterprise of a firm. And when you do that, you realize that the level of indebtedness in this company is actually quite low. We have about $3.2 billion between cash and investments, and we have about $1.7 billion in corporate debt, and that was the convertible bond deal we did last November.

What's really important about that convertible bond deal we did is that converts at $215 a share, meaning there's no dilution to the shareholder until our stock price gets to $215 a share. And that's obviously very attractive financing. You have 0% interest, so it's a no coupon deal and it doesn't convert till a pretty high level from where we're at today. So, we think we've done a really good job in capitalizing the business to really give us all the strength to continue to be very aggressive to scale our network.

Ramsey El-Assal Q
Analyst, Barclays Capital, Inc.

Okay. Back to a couple more questions on the outlook. Can you help us understand the quarter-to-quarter seasonality implied in your second half outlook? Why is the seasonal slowdown expected to be more pronounced this third quarter? I know you have a history of beating raising. I just wanted to understand if there was any conservatism in the guide or what were the drivers there.

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

Yeah. Look, our guidance does reflect our current view, full stop. And, we have said from the very first day we went public that we're not going to set expectations in excess of what we will deliver, meaning, we just – we think it's really important that we communicate to the market a number that we intend to deliver, and we take that commitment very, very seriously inside of Affirm. So, when we put a guidance number out there, we intend to hit it.

And we do so not with a ton of – we're not trying to game the system here. We're trying to make sure we give a number that's a solid and reliable number for investors to think about and model the business off of. In terms of seasonality, I think it's important for everybody to remember that our business is exposed to underlying retail trends. And retail is a very seasonal business. If you think about – my Head of IR says, they don't call it Black

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Friday for nothing. There's a lot of demand in fiscal – our fiscal Q2, calendar Q4 and we saw – we were huge beneficiaries of that last quarter.

If you think about the kind of programs that we were doing, Walmart, for example, announced that they were removing their layaway program and were leveraging Affirm's solution instead. Walmart doesn't have a layaway program in Q1, calendar Q1. They have it for the holiday season and that's because that's the time consumers are making large considered purchases. And underlying seasonality in our business has been masked in the past couple of years because, quite honestly, COVID has disrupted so many of the normal retail patterns and trends. We do see that starting to come back to a more normal state.

The other thing that's important with respect to the Q3 guidance is thinking about the connected fitness category. Connected fitness saw tremendous growth throughout all of fiscal 2021 and 2020. When you think about all the shelter-in-place, the gyms shutting down, a lot of folks invested in home gyms, myself included. That trend was obviously very, very strong and creates pretty difficult comparables. And importantly, the seasonality of that business tends to be in calendar Q1. You have holiday season, you eat too much and you get back to the gym. And instead of back to the gym, it was actually back to working out with a lot of connected fitness growth.

And while that business will continue to normalize over the next several quarters, it just creates a little bit of choppiness in the compares. What's important through all that, though, is we're still delivering at the high end of our margin range with really strong GMV and revenue growth well in excess of the growth phase of the business, which means that we're in hyper growth. And I think if you're picking apart the exact timing and one point of growth here or there, I think you're missing the picture because we're building an enterprise that hopefully scales to something much more massive. We're focused on where we're going to be in five years, not where we're going to be at five weeks.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.
Q

The next question is, as Affirm diversifies and does more Split Pay and interest-bearing transactions, can you walk us through how we should think about the income statement impacts on line items like interest income versus merchant network revenue and on the expense side, your credit provision and loss on loan purchase commitment?

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

Yeah. So, wind the clock back for when we were first going public. We had a lot of concentration in our largest merchant partner who was Peloton and frankly, that was one of the big criticisms of the company is, hey, these guys are heavily dependent upon one merchant. And over the past 1.5 years, we've done a really good job of diversifying the merchant base and the GMV mix is really different than where it was just 1.5 years ago. In fact, no merchant in Q2 was more than 10% of our total GMV. And so we're really proud of that.

But, that – the way we've diversified is by strong growth in our enterprise relationships like the Shopify platform relationship, which is today exclusively Split Pay, as well as our business with Amazon and Walmart. The Split Pay business in particular has a very different profile. If you think about our total revenue as a percentage of GMV, in our non-Split Pay business it can be as high as 10%. Now, our Split Pay business, whose revenue model is exclusively charging merchants, there's no consumer fees, no consumer interest of any kind – unlike our competitors, there's no late fees anywhere in the system and so, you look at the fees the merchant pay, and that's the only revenue model in that business.

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The chart that you see on the screen right now shows the fees that we have been charging merchants by product line and if you look at that Split Pay line, what you see here is kind of in the high 4s, or just under 5% range of Split Pay revenue, which is obviously much lower than that 10% number that I talked about before, because this slide shows merchant fees, but there's also consumer interest, which layers on top for our interest-bearing programs, which again can generate a lot of revenue. And so, what that means is, there's a fundamentally different revenue and margin profile on a percentage of GMV.

We've not given any specific guidance as to where folks should expect that to be, but what you see is less revenue, okay, because it's on a percent of GMV, these things have a lot less revenue, but you also have a lot less cost. Right? So, the duration of the asset is very short. These loans last six weeks on average, and so we talk about that as a weighted average life, which is how long the dollar is outstanding, which is three weeks. And so the funding costs come way, way down on a percentage of GMV, consistent with the shorter duration of the asset.

One way to think about it is how do you annualize that revenue model? And when you do a six-month loan, you can analyze that by multiplying it times two. When you do a six-week loan, right, the multiplication is a lot larger than that and you quickly realize that the annualized revenue content is quite good, even though on a percent of GMV it's low.

And then, you mentioned loss on loan purchase commitment, which is a word – it's definitely a mouthful and it's a bit of a complicated accounting concept. But the way that works is, when we originate a 0% loan, or more specifically, when our partner originates that loan, we have an obligation to buy it from our partner. And in the case of programs like say, what we do with large furniture companies where we have long-term 0% loans, we take a loss associated with the difference between the consumer par, the principle, total loan amount and the fair value of the loan, which is admittedly below par.

Now that all works for us, great because we – the merchant is paying us a large MDR. So the transaction economically, it's good for Affirm, but the mechanic is this pretty big loss on loan purchase commitment. And the categories that saw the most growth during COVID, kind of the tailwind categories, connected fitness, home furniture – furnishings, et cetera, those tend to be our biggest long-term 0% programs. And so, they have the most loss on the purchase commitment. So you're going to see that number come down on a percentage basis over time as we replace that business with both interest-bearing and Split Pay businesses.

Did we lose Ramsey? The adventures of technology.

Ramsey El-Assal
Analyst, Barclays Capital, Inc. Q

Michael, can you hear me now?

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

I hear you, great.

Ramsey El-Assal
Analyst, Barclays Capital, Inc. Q

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It must be some solar flares happening today because the internet connection mysteriously dropped out for reasons that I can't quite understand. So, where I was at was the last question on guidance. I promise the last one, which is, what do you need to hit your long-term financial outlook, particularly for revenue less transaction costs of 3% to 4% of GMV? Should we expect that metric to improve? I think this is a key part of this question. Should we expect that metric to improve in fiscal 2023 as you scale Amazon and other partnerships?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

So I want to reiterate that 3% to 4% is the range that we expect to deliver in the long run. And we have been significantly above that level in the past few quarters. Part of that is because when COVID first started, we took pretty – some extra provisions for losses on the balance sheet coming into our allowance, which show that those income statement as provision and over the past 12 months, as we've loosened the credit box, we've also been releasing that provision in a more normalized credit environment. So, we've been in excess of that number for a while and we do expect that to continue to be very strong but normalized. And that's the reason why we have given guidance around 3% to 4%.

The key question kind of behind the question is how do you get to 3% to 4% long term? And there we've done any number of modeling and it comes down to a couple of basic questions like what is the mix of business? So clearly it's Split Pay. If you're talking about a business that has only 4% or 5% revenue, you're not going to make 4% margins, right? So the margins are lower in Split Pay again on a percent of GMV. And so you're going to think about what's the mix across the two. We started the fiscal year by telling the market that we expected 10% to 15% of our GMV to be in Split Pay. We updated that range to 15% to 20%, and it was as high as 20% last quarter.

And so that will impact that percent number, but what's important is despite this explosive growth in Split Pay, and we're really proud of that growth, we're still growing our interest-bearing and long-term zero programs quite well. And so it's – it's about the mix across those three programs. I think at scale we feel really strong about the margin profile across all of our platforms, but there will be some learning as we grow and some optimizations that we do.

It's our experience that these enterprise relationships, they don't come out the gate with the perfect volume or margin profile. Those things take some time, and that's okay. We have several at bats at this and we kind of know what to expect and what to work on. I mean, one of the things that we've recently talked to the market about a little bit is we launch with only one product on both Amazon and Shopify, and that's not where we intend to keep it. We intend to launch additional products in Shopify for Shop Pay Installments, we launched with just Split Pay.

For Amazon, we launched with just interest bearing and we plan to get longer-term zeroes and Split Pay on – onto Amazon. We plan to get interest bearing and longer-term zeroes on Shopify. And we know there's real good market demand there. And so, all of these factors will just add to this idea that these relationships, as they scale, would deliver better margins over time and we have a lot of conviction around what that looks like. I think that's the most important thing. I guess the most important thing for investors about how we think about the value investing in Affirm. We think we can create massive scale with really good unit economics that will flow through to our adjusted operating income measure.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.

Q

The next question I have is from retail investor, [ph] Srinivas B. (00:25:16) and it's about competition, and the question is as follows. Most of the big banks are introducing buy now, pay later into their existing systems. How does Affirm plan on tackling such competition?

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

That's a great question. Thank you. We feel really good about our prospects for competing with what we call traditional financial institutions, so called, big banks. A couple of observations, the fundamental shift in consumer behavior that we have taken advantage of in creating our business, the way that we are writing, is a consumer's walking away from traditional financial institutions and their products. And that is a trend that is going to happen whether or not we're here. We're proud to have helped create it. But we know that's a fundamental seismic shift in consumer behavior and we take advantage of that and create real value for our shareholders because of it.

The traditional financial institutions suffer from a few pretty big flaws. First, they're not good at technology. They spend a lot of money on it but it's difficult to convince the world's best engineers to go work for a big bank. They want to work somewhere where there is a real mission and a real alignment for what we're doing. And Max, our CEO, has spent a lot of time on this, a few earnings calls ago, walking through how he thought about building the company with our mission first, and that creates a huge advantage for us.

The second thing is really the mission as it impacts consumers. I would venture a guess that just about everybody listening here has been the victim of some sort of annoying fee and maybe even a catastrophic fee. Maybe they took out a deferred interest loan and didn't understand that interest would be charged retroactively. Or maybe your account card expired or something and you got charged a late fee, something that just grinded your gears a little bit or maybe even really hurt you financially. Affirm's basic promise to consumers is we'll never do that, and that promise returns with consumers feeling a lot of loyalty to us.

So the traditional banks don't worry us as much. We tend to be able to execute pretty well around them. I think the other side of competition is the smaller players, the players who are kind of in the cohort of these new alternative payment methods, the BNPL category broadly. And there our competition really falls short because they're not able to offer the same breadth of products. And ironically, they're still addicted to things like late fees, where they need those to compensate for bad underwriting decisions, whereas we believe that our underwriting is actually capable of finding the right risk and pricing it correctly so we don't need to charge consumers late fees to make up for that.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.
Q

And maybe sticking on the topic of competition, Michael, what are you seeing in particular on this sort of enterprise versus SMB side of the market?

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

Well, again, I think we're really proud of our success on the enterprise. When we were – we were able to win relationships with Shopify and Amazon and continue to scale relationships like Walmart, we think those are really loud statements to the market that when it comes to enterprise, that's what Affirm does best. And we win those relationships because of both the consumer orientation and the technology that we think is unrivaled.

The SMB space is really interesting. That's the so-called long tail of merchants. And in e-com, it's very, very, very long. And part of our strategy behind trying to win the relationship with Shopify, which if you think about it as an enterprise relationship, that's where scale and technology and consumer treatment matters a lot. But it's a conduit to serve that long, long tail of merchants. I'm talking about the 170,000 merchants on Affirm today. A big driver of that is the Shopify relationship, and these are really small merchants. And it's, honestly, I think one of the best

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things of that relationship has been our learning about some of these very, very small businesses and just the power of a true small business. And that's like really small.

I think more mid-sized businesses is where we're having kind of our traditional competitive fight. We're out in the market trying to win those deals and you're going to continue to see us aggressively win those deals, but again with discipline. We think it's important for us to make sure we're not upside-down in these relationships, where frankly that discipline is going to serve us quite well in the long run.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.

Q

That is helpful. The next question comes from [ph] Hemming P (00:29:52), and the question is as follows. What is the total addressable market in the US? And given the rising competition, what percent of that TAM is practically achievable? Maybe I'll bolt on a little bit to that question, which is sort of like along the same lines, while buy now, pay later today represents, call it, a low-single-digit percentage of broader e-commerce spending, what about by merchant count? Is there a – you kind of addressed this a little bit in a small market, is there a long tail of merchants who need but don't yet have buy now, pay later, and you just commented on that a little bit, but is the opportunity now about growing customers and increasing the frequency of repeat usage?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. So, I think the opportunity, we're in the very early innings of this, kind of broad adoption of these alternative ways to pay, these new payment networks. And we think that the market may be as high as 5% penetrated as a percentage of e-com today and we think that there's no reason to believe it can't be scaling significantly from there. So, we're very early on this, and that's just in the e-com sense. We also believe that the broader retail environment offline is a huge opportunity for us.

And so, we haven't put specific numbers out there for TAM, but like honestly, these numbers are gaudy, they are huge. The card market is over $1 trillion and we think that we're addressing this kind of fundamental way consumers pay. One of the reasons we're so excited about our Debit+ product is it really does expand the kinds of transactions that we can serve. So, if you think about our core product today, we tend to serve higher AOV purchases. So, think about buying a TV, a set of tires or maybe even a couch.

That's very different than buying a cup of coffee and you would say, well, we don't need to BNPL a cup of coffee, and we completely agree. But a consumer is having to today to decide between the two and one of the things that we seek to do is really have the consumer separate out the financial instrument from the payment tender device. And that's the vision behind Debit+ and we'll talk more about that if you want. But that – that really means that for us, we're trying to open up where the TAM is all spend, and like that's huge.

So, I don't think we're TAM constrained really at all. I think the sources of growth are really still adoption of the product. There's still a bunch of merchants who need to adopt it. I think it's about going international. Today, we're mostly US. We have a small business in Canada and a very small business in Australia. And for us, it's also about the widening of the transactions that we serve. We want to mean something to every transaction. And that's where the growth is going to come from us. And to do all that, we need more consumers and more frequency.

In our last quarter saw really good traction on that, significantly added the amount of consumers. We actually grew frequency, which when you grow users as fast as we did, growing frequency is really impressive and we were pretty proud of just the – we have a chart in our earnings supplement that shows the number of repeat transaction which is actually accelerating. And that's a really good sign for the business, and that's the reason

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why we talk about network effects. That's where the growth is going to come from. We're going to be focused still on winning the remaining merchants, on expanding the number and kind of transactions that we can serve and continue to scale the user network.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.
Q

And you just touched on this, but what about the in-person offline effort? What does it take to get there? I guess over time you expect that to become an important – a more important channel for you guys.

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

Yeah. e-com, as we all learned during COVID, is a really critical part of commerce. And it's not even – what's really interesting to me is I think we probably all could have said that 10 years ago and the trend has just continued. And that seems quite obvious to a younger consumer. I think to an older consumer, it's something that they're still slowly adopting, but COVID saw this very radical, very quick change. My mother and father-in-law are not heavy e-com users, but were buying their groceries from an app during COVID because they want to go into a store. So we really did see this kind of acceleration of that.

But despite that, about 80% of commerce is still conducted offline. And so it's a much bigger market. Admittedly, it's not [ph] growthful (00:34:17) like e-com is, but nonetheless, it's huge. And so, we think about that as a really important piece of the total pie. It's something that I don't think – I think if I'm being honest, we really haven't cracked that nut yet with the right product.

Today, consumers can use a virtual card offline. They can put it inside of a Google or Apple Pay Wallet after taking out a virtual card through our app. So you can do that. But the adoption hasn't been super stellar. And one of the things that points us towards putting a lot of effort behind our Debit+ product is we think that has a much greater opportunity to get real adoption and traction. We're really early so we don't have many data points to share yet, but we're really excited about what the debit card will mean for offline purchasing.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.
Q

Great. And this is a question from [ph] Barbara W (00:35:11), and it asks – the question is, are there plans to add additional products and services to be able to access Affirm? You've touched on a couple of threads here already with this, but that's [ph] Barbara's (00:35:23) question.

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

Thanks for the question, [ph] Barbara (00:35:26). And, yes, I think one of the things that kind of reconcile this investment posture we have, where we have a great number of engineers – software engineers, they write code, they build products, these products change the world, and the investment that we're making is in the team to build them. We like to say that we have billion-dollar businesses on the cutting room floor of Affirm because we are relentlessly prioritizing our effort against what is the most actionable and concrete in the near term and we're having to constantly deprioritize or push back and push out projects because we don't have capacity to address that.

And part of scaling responsibly is being able to do that privatization. But we feel like there's just so much opportunity. You saw what we think is an acceleration of our product road map over the past 12 to 18 months. In

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our September investor forum, we talked about a few of those things, Debit+, as we discussed, but also our SuperApp, which really took us away from being a servicing and shopping-only app to now we have servicing and savings, and shopping and rewards. And you can even, pretty soon, convert your savings yield into crypto.

And these kind of features are all about driving better engagement with the consumer because our mission is to improve lives through on its financial products and that's very broad. Our mission is not to help sell couches, you know, it's to improve lives through honest financial products. And so, we feel like if it's an honest product and it can help people, we're going to build it. And there's a lot of products out there that can do it.

Our founder, CEO, Max Levchin, you know, he is an entrepreneur's entrepreneur. He is about the most product-driven human I've ever met. And I – we mentioned this, I think on a call recently that he's got a team of his – he calls them his ninjas that actually go out and prototype new products. And, you know, trust – I think you should take me at my word that innovation is alive and well here at Affirm.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.

Q

That's great. And maybe this is another related question, something related to [ph] Barbara's (00:37:37) question, something that I've wondered about. What – will the products that you have at large enterprise partners today, is that something that that product suite is sort of fixed? To what degree will we see those products evolve over time? And, I guess, specifically, in places like Amazon, will you see 0% or higher MDR offerings introduced at some point?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. To maybe use a baseball analogy since we finally have baseball back, probably not, but my favorite sport, but nonetheless, since baseball back – is back, we kind of think of it as like we're in the middle of the national anthem before the game has even started. There is – there's a lot of road map well ahead of us. So, at Shopify, we launched our Split Pay offering, which is a short-term, 0% offering. Consumers put 25% down and then they make three payments behind it every two weeks. That's a very, very short product. That's what we launched with at Shopify. And that's like the most competitive thing that you see and what people call BNPLs. It's a product that lot of our competitors have.

That's where we launched. But we actually have a very big business with Shopify merchants already, not through Shop Pay Installments, and we're really excited to bring longer term and 0% offers and interest-bearing offers into the product set for Shop Pay Installments. And on Amazon, again, we launched quite quickly with an interest-bearing program and that was launched just before Black Friday in our fiscal Q2 calendar Q4. And that program was honestly truly the MVP and I'm really proud that we were able to get it launched.

But I think if we're being really fair with ourselves, we have a lot of optimization to do both in terms of how the offers are communicated to consumers, where in the checkout funnel they see them, and these are – from our experiences at other enterprises, these things can take quarters or even years to get perfect and that's okay. In fact, that's a key source of our growth here at Affirm is that we're continuing to scale our existing merchant relationships both with new products, as well as optimizations on those products. So, we feel like there's a ton of road ahead and a lot of additional products that continue to roll out.

What I think is most interesting is that the conversation with these partners tends to not be overly constrained. So, they're out to solve the consumer need and if the product solves the consumer need, there's a lot of appetite for broadening the offerings on the sites.

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Ramsey El-Assal

Analyst, Barclays Capital, Inc.

Okay. I wanted to shift the conversation over to credit performance a little bit. And on the last earnings call, Max said something interesting. He said, we choose our delinquency rates as an input. Could you unpack that a little bit? I mean, how do you think about your ideal or sort of target credit box? And I will mention that this was a similar question that we got from a retail investor, [ph] David A. (00:40:43), who asked about your credit losses and whether they're going to change for the better in the future or change over time.

Michael Linford

Chief Financial Officer, Affirm Holdings, Inc.

Yeah. This is like, really, if I were to implore investors to spend time on one topic, this is the one I think is most important to understand why we have a huge advantage in the long run. If you think about the alternatives, when you think about the other traditional unsecured consumer credit, which is the code word for credit cards, their business model works like this, they give consumers a line, consumers spend on that line and then credit happens to them. And often times, way, way, away from the line was issued, consumer could be sitting on a line for six months, a year or two years before they begin to see delinquencies. And that's just not at all how Affirm works. Affirm approves every transaction today, and so when a consumer wants to get their next dollar of lending from us, we have to approve that transaction at that point of sale.

And why is this an advantage? Well, it means that we have lots of little approvals and lots of little delinquency signals. And I mean lots. We measure delinquencies – start measuring delinquencies when the consumer is first four days late, we call that DQ4 and then we measure it when they're 30 days late and so on. And we put out the statistics in our last supplement on DQ30s but internally we monitor at DQ4, which means we have an understanding every 34 days – so 34 days after the origination, which we see every day.

We look at how that credit is performing and the thing we're really looking at is, is it performing consistent with our expectations? We can make good margins with high losses or low losses. The important thing is to not have it be a thing that happens to us, but something instead that we pick. So we have our own – a proprietary scoring model, it's called ITACs, and we get to pick the level of approvals that we have. And we might, for example, approve – set an approval cut off at 92.7 – making that number up. It's 100-point scale and it's pretty concentrated at the top end of the range. So, we max the cutoff at 92.7 and that cutoff should generate an expected loss or a DQ4 of some number, and then 34 days later, we look at that data and we take in that signal. And if the losses are consistent with that number, we can continue to operate the business.

If the losses vary from that number, we have to take action because it means either the consumers are worsening or our underwriting model is worsening and drifting. And of course, the action there is to then retune the model and get it right, but if the consumer is worsening, that's where we have an opportunity to correct it. And because we have such a short asset, and because we get so many signals, we're able to fine-tune the machine and we're nimbly driving around in the obstacles that you might have in the credit environment and being hyper reactive. And our hands are always on the dials.

That's just a fundamentally different answer or approach than traditional unsecured consumer lenders like credit card companies. And so, we have a real advantage there, and that's a structural advantage that allows us to do better. And that's on top of our actual underwriting advantage, which is also very real. We're better at underwriting, but that structural advantage allows us to really dictate the level of loss that we want. And we make that decision every day and that is, again, we think about it very differently than what you see elsewhere.

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And with respect to [ph] David's (00:44:17) question on whether or not we expect credit losses to change for the better in the future, what I would say is, we are – we're in control. I got some grief about that line, but I guess, the truth, we are picking the level of loss that we have. And so, if it goes up, it's because we were trying to approve more consumers and we thought we could do that on a profitable basis. You'll see that show up in our revenue less transaction costs. And if you see that number go down, it's because we were trying to be thoughtful about maybe the macroenvironment or thoughtful around the level of merchant fee or interest income that we were getting. And the mix of business is a huge driver in that.

So, I wouldn't read into the credit numbers as an indication of quality of underwriting or quality of the consumer. Think of it as, we've chosen to run the business at those levels.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.
Q

Interesting. Okay. And last quarter was the first in several where we saw significant sequential improvement in the transactions per active customer. Can you share any incremental details around your older cohorts? Are you starting to see longer-term users transact more frequently in more meaningful ways? What sort of repeat behaviors are you seeing from the newer customers on the other side of things?

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

Yeah. So Q2 transactions were up 218%, and the problem is these numbers are so big that like it blew us away. What's really important – we don't talk about this a lot, but what's really important is to do that kind of a scale and transaction count, you actually have to have really good infrastructure engineering teams because those things tend to scale. Your infrastructure and technology requirements scale with how many times you're approving and transacting, not with dollars. And that transaction count, 218% growth is just – it's staggering how many more consumers were transacting on the platform.

This is my favorite chart from the quarter, and it really highlights to me the evolution of where Affirm has been and where it's going. As I mentioned earlier, when we were going public a little over a year ago, we're very concentrated in one large partner and we knew we would be diversifying, but frankly, even we were pleased with how quickly we were diversifying and then how that was going to show up with different engagement statistics. So, we were – look at the chart. I say like, look from the fiscal Q2 2021 and then look to the left, and you see our trend historically and it's okay, it's just not a particularly compelling trend. And then look to the right. And what you see to the right is the investments we made in diversifying the business into lower average order value transactions and driving a step change in consumer engagement.

That chart has two bars. It has the first-time customer transactions, which were 1.1 million last year, growing to 3 million this year. That alone is a really impressive and awesome stat and we would be very proud of that. And that's why our consumers grew so quickly to – they grew 150%. But then look at the bottom bar and it's something I'm most proud of. We grew repeat transactions. That is consumers coming back to us to hit the program again from 2.7 million transactions last year to 9.2 million, and that growth is just awesome. And if you think about the total user growth, 150% user growth, that's masking the actual underlying frequency.

And sorry for the professorial lesson here, but this is like really exciting to us. And so that 2-point – we talked about 2.5 was the total number of transactions per user. That number is being really masked because we're driving so many new users. So, the math on that is, how many users you have and how many transactions and that gets you to 2.5. Well, if you think about it as just the number of transactions for repeating consumers, this chart can give you a good indication for just how quickly that is growing.

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And that's intentional. That's a thing that we've done to the business to really broaden the number of transactions that we serve. And it's our enterprise strategies clicking into place and we think really scaling the user network. And at the end of the day, we look out five years and we have targets for ourselves around how big the network needs to be and what the behavior of the network needs to be and what kind of network effects you need to see. And this is probably the most important stat for the quarter because it shows that we're driving real network effects in this business, which creates this kind of permanence, right? It creates this inevitability once you get to scale.

We're still early, so I don't want to declare any mission accomplished yet, but this is such a good leading indicator for what this business looks like at total scale.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.

Q

Great. I wanted – before we get close to running out of time here, I wanted to ask you about the inflationary environment or the macro impact on the business from higher interest rates, inflation on business performance on any aspect of business. Maybe you can comment on that. It's a question we get pretty frequently.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

A

Yeah. I think, first, we believe that our product is a lot more valuable in a higher rate or high inflation environment. If you think about the value of financing, it's obviously highest whenever underlying rates are higher. Our product is money and when the cost of money goes up, which is what you measure in things like rates, then your product is more valuable. And that means that consumers who get 0% offers understand that there's more value in that offer and consumers who are paying interest rate – interest to us understand that that is also more valuable. And that's a really important backdrop point because rising rates do impact our costs, but we believe very strongly we can mitigate that because our product is more valuable in a higher rate environment.

Inflation didn't limit our growth in the second quarter. You didn't hear us talk about concerns with the consumer last quarter. We saw consumers out transacting in a pretty high level. You saw that in the data we just flashed on the screen. And that's because our product is different than what you might think of. So, a lot of folks who just do pure payments, right, are just trying to transact, they have some headwinds here because higher prices in an inflation do – can slow down consumer spending sometimes. But, for us, it highlights the importance of paying over time that things cost more, consumers have a greater need to pay over time. And I think that's what you saw a little bit in our fiscal Q2. And, frankly, we were convinced we're going to continue to see.

I think the second order effect is probably the one we're spending most time on internally, which is, will these higher rates impact consumers in such a way that actually impacts businesses' abilities to keep them employed. And I always talk about the credit side of rates is like the really important side and to date, what we've seen is just a really strong labor market.

I think as the labor market, that is to say employment, starts to change, there might be an impact there, but as of today, we see just a really robust labor market and that means that consumers are fully employed, which in turn means that that their ability to continue to conduct commerce is quite strong and we're the beneficiaries of that.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.

Q

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Interesting. I see. So there's an offset there, inflation on the one side and the tight labor market on the other side. That makes a lot of sense. I want to ask about the regulatory environment and more specifically, can you kind of contrast your positioning there relative to the products, services, policies that you offer relative to the market? How worried are you about a regulatory environment that gets tougher for buy now, pay later?

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

It's a really good question. It's one that we get a lot. And I think I think there's a lot of confusion out there maybe on even what our model is and how regulators might see it. So let me just lay out a few pretty strongly held beliefs that we have.

First and foremost, as I said before, our mission is to build honest financial products that improve lives and I talk a lot about this with candidates as we're hiring them. If you're not aligned to that mission, you won't fit in here at Affirm. We truly have this as like a North Star, and I've got a hundred examples of decisions that we've taken that maybe weren't the most optimized for the short-term results of the business that we're putting the right approach to how you treat consumers and building products that actually improve lives.

And that's because we believe that's a better business. We believe that's better for the shareholder in the end because the network is more valuable if you put that as your North Star. So, it's not just because we are actually motivated by the goodness that that statement carries. It's because it is also good for business that we do that, and it will be good in the long run.

And so, when we – that approach is an incredibly important component of any conversation with the regulator, whether we're meeting with an attorney general in a state and we talk about our ability to both increase access to credit and create alternatives to predatory financing. The idea that you can do both at the same time is a really interesting thing to many of the states' attorneys generals that I talked to.

The other regulatory bodies like the CFPB who recently announced that they were going to pass some data from all of the BNPL players around the product, those inquiries, we think, are very welcome. Firstly, we have nothing but respect and deference for how the CFPB might go about setting rules. But our view is that the more level the playing field can be, the better for Affirm. Affirm has long held that our transactions are loans and we show Truth in Lending Disclosures. We believe that late fees are a thing that harm consumers, and we welcome any attention or spotlight around those things because we don't do that.

You know, in the CFPB data request which is public, you can go online and pull down what the – the data they ask for, they asked us to identify what our late fees were, what our initiation – account reactivation fees were, and they go down a list of fees and we don't charge them. And so, our product stands out in that way and that does not mean that we're perfect. It's – anytime you're dealing with any of these kind of products, it's easy to not be perfect, and we're always striving to be better, but we think we stand apart because of how we treat the consumer, and in the end that's what matters we think, most.

We hire a lot of folks from those regulatory bodies at our company and they tend to pick us, we think, because our approach is exactly as we lay it out. And we try really, really hard to always do the right thing.

And so, in general, we think it's a good thing for the industry and a good thing for us. I think it's a good thing if regulators ask people to actually underwrite transactions and help keep consumers from being too extended. That's a real problem in our space. And so, we just really feel like it's the right time to engage and I think they're doing it thoughtfully. Now, it won't happen overnight, but we think it's a good thing.

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Ramsey El-Assal
Analyst, Barclays Capital, Inc.

That's great. Yeah, it definitely seems like guys are relatively well positioned for sure. Last question here today is basically of all the things that we've talked about and anything that we haven't talked about, what excites you the most about the business? What do you see as the most attractive opportunities? Is it products? Is it network expansion? Now, you mentioned international growth. Like what really gets you cooked up here over the long term as we think about Affirm?

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

Yeah. The thing that gets me out of bed, excited to come to work every day and lead the finance team here is the fact that I know that we're in the middle of this major change in consumer behavior. The thing that we've been talking about has – is finally seeing the light and it's gaining real traction. The idea of paying over time, separate and apart from credit cards is going very mainstream, and we think we're the market winner. We think we're the winner of this market.

Big markets like this, where we think we can win and create real moats around our business and print really strong unit economics leads to a really, really big enterprise at scale. We think we're way early and so we have a chance to shape the industry, but the thing that makes me so excited is, I know that the thing that we're doing here and the things underlying it are going to be really massive at scale. And there's nothing more fun working on problems that are really hard that help consumers and – have massive scale to them and that's the thing I'm most excited about, is delivering on this core vision and tapping into this change in the way consumers want to understand payments and credit, and we're best positioned to do it.

Ramsey El-Assal
Analyst, Barclays Capital, Inc.

Sounds exciting. Terrific. Well, that was our last one, Michael. Thank you so much for your time today, and it was a great pleasure.

Michael Linford
Chief Financial Officer, Affirm Holdings, Inc.

And thanks and thanks to our retail shareholders for logging in. I really appreciate the chance to answer some of your questions, and I appreciate you guys engaging.

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