Barclays 14th Annual Emerging Payments and FinTech Forum – Fireside Chat

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Call Participants

Affirm
Brooke Major-Reid, Chief Capital Officer
Rob O'Hare, SVP, Finance

Analysts
Ramsey El-Assal, Barclays

Presentation

Ramsey El-Assal
Barclays Bank PLC, Research Division
All right. Our next fireside chat of the day is with the Brooke Major-Reid, Chief Capital Officer; and Robert O'Hare, SVP Finance of Affirm. Brooke and Rob, thank you for being here again. Pleased to have you.

Ramsey El-Assal
Barclays Bank PLC, Research Division

Maybe Brooke, you could recap from your perspective what the highlights from the recent earnings call were from sort of a capital perspective, if that makes sense.

Brooke E. Major-Reid
Chief Capital Officer

Yes. No, thanks for asking. Hi, everybody. Quite proud of the quarter and sort of the year-over-year performance. Added over $4.2 billion of incremental capacity. We actually did our 24-X1 deal, which was a $725 million, including the resid, off-balance sheet static deal, which priced 100 basis points tighter than our last deal, our static deal in November. We did 24-A, another ABS deal, revolving ABS deal, which also priced really attractively and was met with really strong demand. We added quite a few partners over the last several years in addition to the capacity that we had across all the bilateral channels of warehouse and forward flow.

So really constructive start to kind of -- not start, but constructive quarter. Last couple of quarters actually have been very constructive. The engagement with investors has gone a long way. So when you think about where we are now with respect to the pricing dynamic, we believe that we are finally incredibly getting credit for the credit outcomes we're generating.

And that's been a very positive experience for us in capital, but also when it comes to sort of contribution to the unit economics of the business. We're sort of in a position where we can sort of have conversations with our partners that are healthy and constructive about where our assets fit relative to the broader performance in both consumer and other structured finance products. So a really good quarter.

Ramsey El-Assal
Barclays Bank PLC, Research Division

That's great and well deserved. What does the environment look like to you guys at this point? The consumer credit environment-- your credit performance has always been quite good. What are you seeing out there when you look across your portfolio from your perch?

Brooke E. Major-Reid
Chief Capital Officer

Yes. That's -- it's always quite interesting. People tend to put the consumer in the sort of broader category, and we have certain advantages in terms of how we engage with the consumer relative to merchants. But we're seeing that the consumer continues to be resilient. We are managing credit the way we always have been with respect to our delinquencies have held in year-over-year -- I'm sorry, slightly down year-over-year.

But if you think about how we are approaching sort of underwriting, we underwrite every transaction, so the idea that we can actually meet a consumer, see where they are sort of on their journey is actually something that benefits us given the loan duration and just the overall performance. So we're seeing the consumer continuing to spend. Obviously, some of the categories, like the COVID categories are down, but we're generating a lot of positive momentum from the card but also in general merchandise, in certain segments as well in terms of travel.

So we're seeing the consumer continue to spend while also maintaining an approach to underwriting that allows us to generate the credit outcomes that are better than sort of the broader consumer landscape, which is a different landscape relative to the asset we generate.

Robert W. O'Hare
Senior Vice President of Finance

Yes. And I would just echo the point that Brooke made around underwriting every transaction every single time with consumers that are new to the firm, but also with consumers that we've worked with before. I think that gives us a really nice structural advantage versus a credit card line or some of the longer duration loans that are out there. It's a really short duration asset that we create. Our average order value was about $300 in the most recent quarter, right? So we're extending credit in really small chunks, and that book turns over really, really quickly.

So if we do have pockets of stress, we're able to see the data pretty quickly in the early repayment trends. And we're able to course correct really quickly as well. So I think that, more than anything, has served us really well in terms of how we manage credit and how we expect to do so in the future.

Ramsey El-Assal
Barclays Bank PLC, Research Division

And I think that's showing up in your -- in the ABS market in the sense that it seems like you guys have built a constituency of participants there and some credibility in terms of your ability to manage credit consistently at healthy levels. Maybe talk a little bit about the most recent deal you've done in the ABS market / in general, year over year, how does it feel at this point?

Brooke E. Major-Reid
Chief Capital Officer

Yes. So obviously, very happy with the reception we got both on the revolver we did earlier this year and the most recent static deal, 24-X1 that we did post the close of the quarter. The market feels very constructive.

The level of fluidity we saw sort of in '21, I wouldn't quite say we're back there yet. There's risk on but selective risk on. So I'll give you an example. It was clear to us that we could have structured the deal probably a little bit more -- getting a little bit more leverage out of it.

But at the end of the day, we understood that investors are still sort of cautious about consumer headwinds. And while we have confidence that we'll continue to perform in line, we wanted to make sure that the deal was well structured. So we didn't structure down to sort of the sub-investment-grade tranche, and we were able to sell the residual that also met -- was met with incredible demand.

So I think on the whole, not only are we happy about the fact that we're getting the reception from investors, but we also have to make sure that we're both structuring deals and sort of producing collateral that investors will want to invest in. Because I don't think the market is back to the point yet where it's just all risk on at every tier. There's a price at which even for lower tranches, that there are certain investors that won't bite at that level.

And so we have to be very cognizant of that. The overall reception, I mean, once you get past 3x oversubscribed, it's like, what's the point, but it was about 6x oversubscribed. We were able to sell through the residual. We had 100 basis point tighter coupon than we had in the '23 deal in November.

So what that says to me is that we can't take anything for granted. We have to continue to maintain the discipline, and it still feels like the market could move away from you if you don't continue -- if we're not sort of vigilant and continue to maintain that discipline around credit. And you could see that sort of in loss assumptions and how people are thinking about structures in the market. I think they're being very selective, and we have been a beneficiary of that.

Ramsey El-Assal
Barclays Bank PLC, Research Division

And how has your -- how has your relationship with your funding partners changed over time? I mean I think maybe we've since touched on a little of the answer to this question, but it would be interesting to hear how it contrasts your interaction with funding partners now to some years ago when the firm was less established.

Brooke E. Major-Reid
Chief Capital Officer

Yes. So actually, I'm proud to say it hasn't changed that much in terms of the level of engagement and transparency. We just have more stakeholders now because we've grown the book. So with that, we've done things like increased our engagement and exposure to our executive team. So we did a non-deal road show, which obviously, you all here helped us get on the road, but really demonstrating our commitment as an executive team to the ABS and to our bilateral funding partners.

So we have regular monitoring conversations that we have with forward flow and warehouse partners. We also increased our engagement, I think, with a broader group of ABS investors as well. In these markets, you have to listen with both ears and sort of digest what you're hearing and figure out how you're going to sort of execute against what you're hearing.

So the dynamic has been very sort of dynamic with respect to just partnering more credibly and transparently with ABS investors. I think the relationship with bilateral partners has been the same. But I think we've broadened our engagement within ABS investors, recognizing that we have to be aware of what their concerns are, the risk, how they're thinking about the world to continue to get access to such a deep credible pool of capital.

Ramsey El-Assal
Barclays Bank PLC, Research Division

I mean one of the things that I think was very shrewd on Affirm's part from the very beginning was just this kind of sort of diversified funding strategy where you're not dependent on any one channel with your multiple points that you can kind of pick and choose from as conditions permit.

I mean -- when you look forward as growth, just -- fast forward a few years, you guys are growing pretty rapidly. Do you see just the existing strategy kind of scaling up? Or do you anticipate any kind of changes to the deeper funding strategy over time?

Brooke E. Major-Reid
Chief Capital Officer

Yes. That's a really, really good question. It's something we ask ourselves and we have the benefit of proactively tackling. The model we have today, will fund them foundationally, likely stay the same. What we -- going back to sort of listening to your partners, particularly around ABS, where we are, becoming even more programmatic at $2.6 billion of ABS issuance this fiscal year alone. We're sort of getting to the point where we're even more meaningful and want to be programmatic, want to provide that liquidity. What that means is we have to figure out ways of aggregating and making sure that how we're issuing is very efficient.

So in terms of scaling, you'll see us continue to rely on the channels we have today, but we will be increasing the efficiency with which we access those channels. And so I won't say too much about how that looks, but it will be foundationally the same with respect to ABS, warehouse and loan sales, both the static as well as the revolving, but you'll see those channels become operationally more efficient for us, while giving us the opportunity to engage with the investors around sort of risk pricing more efficiently. Right now we fund the business based on a vertical slice, just exploring different ways to get risk pricing a lot more efficient as the book scales and growth.

Today, we have $15.6 billion of capital that's just under 70% utilized. That excess has a cost, so we also need to manage how much we're burdening the P&L potentially with debt, that excess capacity, which does typically sit in the form of warehouse lines. So optimizing across channels at scale will be something that we'll have to do very thoughtfully while never being a limitation on growth because we can fund a meaningful amount of Affirm's growth with the existing capital base.

Ramsey El-Assal
Barclays Bank PLC, Research Division

Rob, let me ask you a couple of more general questions about the business just to mix it up a little. So give us your updated thoughts on the buy now, pay later opportunity. There's often questions I get from investors about how penetrated the environment is, what is kind of the -- what is the secular opportunity there? What are your thoughts about the state of buy now, pay alter?

Robert W. O'Hare
Senior Vice President of Finance

Yes. I mean we think that buy now, pay later, especially the Affirm version of buy now, pay later is a better way for consumers to engage with credit. And we think in the U.S. in particular, we're still very, very early in terms of the overall market opportunity. There's $1 trillion of credit card debt outstanding, and that's really the addressable TAM that we're going after. And we've only scratched the surface as an industry relative to that.

I think another way to think about our penetration is to look at buy now, pay later volumes at large as a percentage of U.S. e-commerce volume. And there, I think we're at sort of mid- to high single digits, something like 6% to 7% depending on the estimate. And Affirm is a meaningful percentage of that.

But when we look at our share of cart at some of our largest merchant programs, we're not at the 6% to 7% that the industry is at large. And that gives us confidence that we have a lot of room to grow both the market overall, but also more importantly, to grow within our existing merchant base and with some of our largest partners.

Ramsey El-Assal
Barclays Bank PLC, Research Division

And how does the competitive environment look right now? I think there's a perception that some of your competitors might have gone through a bit of an irrational phase, especially the private competitors. I'm thinking of one in particular that I'm not going to mention.

And basically, they were putting some irrational deals on the table. But as those contracts have matured and as those contracts have cycled and maybe it's a little bit more of a level playing field where capital is not free anymore, you have had some opportunitiesmaybe that you didn't have before you go back in and say, hey, look, if you really compare apples to apples, this is a pretty good deal we can give you. Is that a fair characterization, and more broadly, the competitive environment?

Robert W. O'Hare
Senior Vice President of Finance

I think there is maybe a bit more rationality in the market, maybe not a fully rational market. I think what's important though to remember when we talk about competition, especially amongst the BNPL providers, Affirm included, most of what we do, I mean, roughly 3/4 of our volume is happening with interest-bearing loans.

And then we've got another, call it, 10% that's happening with monthly 0% loans, right? So almost 90% of our volume is happening away from Pay in 4. And most of our competitive set within BNPL is almost running a Pay in 4 exclusive model. And so that intersection for us, where we bump into some of the irrational tactics that you've alluded to, it is actually a relatively small part of our portfolio at large.

And one of the things that we've done to combat some of the irrational tactics is to start to blend our 2 offerings of monthly installment loans and Pay in 4 loans into a single offering that we call Adaptive Checkout. And that means that the merchant is going to benefit from the conversion lift that they would expect from a 0% offering like Pay in 4.

But for us, it makes sure that there's really nice program economics, because interest-bearing loans are our most profitable product. And so we're able to compete and structure that program any way that we need to, to sort of meet the requirements that the merchant has. We can customize the amount of Pay in 4 that's in the program, and that will allow us to sort of lean in on merchant discount rates where we need to.

Ramsey El-Assal
Barclays Bank PLC, Research Division

And Brooke, from a capital perspective, when you talk about Affirm's different product offerings and/or channels and/or partners, is there any tailoring that needs to occur between the funding partner and the product or a funding partner and the channel? Or is it basically the loans that you flow into your funding sources -- there's not a whole lot of pickiness in terms of as long as they meet certain criteria? Are there certain funding partners who are interested only in XYZ types of loans?

Brooke E. Major-Reid
Chief Capital Officer

Yes, that's a really good question. Generally speaking, our ecosystem is built to eat all our cooking. So we do have facilities that -- and we allocate largely on a vertical slice, so representative portfolio, excluding, say, Pay in 4.

Pay in 4 is funded through a particular facility that's on balance sheet. And we've had in the past, 0% specific facility that we stood up. But the rest of the ecosystem may have certain concentration limits here and there, eligibility. But when you step back and sort of look at what's eligible across the funding channels, it's pretty similar on a vertical slice basis.

Now our revolvers, when we do our revolving ABS, that takes the shorter collateral generally. And the static ABS is our longer dated collateral. So -- and that's off balance sheet. So holistically, it's -- the ecosystem we've created is meant to, generally speaking, absorb the loans we originate and we produce.

Ramsey El-Assal
Barclays Bank PLC, Research Division

I like the way you said that, you eat what you cook. That's good. Rob, I wanted to ask you a few questions about international. And I guess in particular, you talked about rolling out the U.K. market. How is that going? And I guess, what does that entail for you to roll out a new market?

Robert W. O'Hare
Senior Vice President of Finance

Yes. It's actually a pretty significant lift. I mean as great as I think we've done in terms of building up the infrastructure around underwriting, around capital markets and around go-to-market efforts in the U.S., we -- in a lot of those areas, we are starting from scratch to a degree when we go into a new market. It's a different consumer to engage with. It's a different set of third-party data providers that we use on the underwriting side. There's new relationships to build. There's a track record to build as well on the capital side.

So there's, of course, some leverage from some of the larger partners that we have that are very diversified geographically and the hope is that we can land some of those partners in any new market that we go to. But otherwise, there is a decent amount of investment and lift. And also, this is maybe less true in the U.K., but it's true in other markets, there could be a different product set that's required to serve the consumer there. So we need to be mindful of that, and we need to sort of invest in building those customizations if necessary.

Ramsey El-Assal
Barclays Bank PLC, Research Division

And is there a road map post U.K.? You don’t have to name the countries, but is the idea over time to kind of gradually and methodically build out a little more international distribution?

Robert W. O'Hare
Senior Vice President of Finance

Yes, we're really focused on the U.K. right now. We've committed to getting that country live this calendar year. We're heads down on that, and we really haven't shared much more on the road map beyond that. I mean I think if you zoom all the way out, we want to be as ubiquitous as we can be in terms of engaging with consumers around credit, and that's a global mission, not a localized one. But we really haven't committed the road map beyond the U.K. just yet.

Ramsey El-Assal
Barclays Bank PLC, Research Division

And again, Brooke, from a capital perspective, and this came up on the earnings call. I say that shamelessly because I think I asked about it, but I'm going to ask you again to check Max's math. What does it take in terms of rolling out a country like the U.K. from a capital perspective? Do you have to find new partners? What does that look like? Are the funding markets as evolved in places -in other countries relative to the U.S.?

Brooke E. Major-Reid
Chief Capital Officer

Yes. And I'm glad you asked because I think it's so nuanced when you sort of try to take something that's worked really well in sort of one country and try to replicate that. I would say, fundamentally, the foundation of what we built in the U.S., and we've seen this in Canada, there are certain channels that work really well for certain markets.

If you look at the depths of, say, the ABS market in Europe or the U.K. versus the U.S., then you look at what we've been able to do in Canada, I think foundationally, as you ramp, there is a period at which you're sort of building up critical mass. So there's a conversation about how much of your cash you're allocating initially to that ramp.

But thankfully, we have global partners in our book today. So we have partners that both facilitate our business from a funding perspective in the U.S. and in Canada. And we are hoping and working towards that being the same, where we can leverage some of the relationships we have in the U.S. from a bilateral perspective. So anticipate that we'll start out in some bilateral form as we ramp, get to whatever that critical mass is and really sort of scale from there.

I think on the ABS side, in particular, that's sort of a more careful balance. You have private ABS, you have public ABS, but sometimes those markets aren't as fluid and as established as how we execute here in the U.S. I think it's a similar construct about sort of scaling and learning and growing over time to build that track record, which is really important to investors. And we're confident that we can sort of have those conversations and have a constructive funding ecosystem that's good for the business over time there as well.

Ramsey El-Assal
Barclays Bank PLC, Research Division

And is it a similar kind of tempo and cadence for just the models themselves, like the credit models themselves in these new markets, it will take time to test and learn and -- the models to get the performance where you want?

Brooke E. Major-Reid

Chief Capital Officer

That's exactly right. So you're having partners who are sort of giving you what they would anticipate being acceptable. And so you're demonstrating -- while you're sort of working to demonstrate your ability to underwrite and deliver good results, you're also partnering with them to say, well, what does the box need to look like in terms of the profile of the loan and the expected performance? So it can be a little bit of a partnership.

But at the same time, we are looking at how we want to approach that market from an underwriting perspective and communicating that such that you can kind of reach an agreement with a partner that feels good to them in terms of the credibility to start and that you can ramp over time and then get subsequent efficiencies in terms of funding costs over time as you demonstrate that track record.

Ramsey El-Assal
Barclays Bank PLC, Research Division

And what about on the -- not necessarily in international markets, as a matter of fact, back in the U.S., what about on the origination partners, the -- your bank partners' side of the business? How is that -- give us a kind of an update on that part of the business and your strategy there.

Brooke E. Major-Reid
Chief Capital Officer

So in the U.S., we have our 3 originating banks, and we're quite pleased with that. We're always evaluating partners. But at this moment, we don't see any need to sort of change where we are with respect to originating bank partners.

Ramsey El-Assal
Barclays Bank PLC, Research Division

Okay. In the quarter, it looked like you guys saw the largest ever, if I did the math correctly, percentage of transactions coming from repeat users. What does this say about the business? Is engagement more important than new users at this point? Is there a downstream impact in terms of credit performance? I imagine the repeat users are probably quite easier to underwrite than the fresh user. What does it say -- this is kind of a deep question, but what does that -- how should I read through that metric into your business?

Robert W. O'Hare
Senior Vice President of Finance

Yes. Driving frequency of use has been a North Star metric for us this year, and I think it's showing up as a counterpoint to the repeat percentage, the frequency. The transactions per user per year is up nicely as well over the course of this year.

So we're really proud of that, of the engagement. I would say, some of our largest and highest growth programs have been driving AOVs that are lower than the portfolio average. There's an inherent benefit to frequency that comes with that.

And we're really happy with the credit outcomes. I mean, you alluded to it in the question, but we do view a repeat transaction to have less risk than a transaction with a new consumer. So it is that much easier for us to say yes to repeat transactions. But while the repeat percentage is high, I think we've also done a nice job over the last couple of quarters of driving net new user growth as well.

So we're not necessarily trading one off for the other, and we're really happy with sort of the frequency and things like card scaling, which are inherently lower AOV and higher frequency as well and also aimed at a repeat user audience. So I think we're really happy with sort of the mix within the portfolio. It's not necessarily -- that repeat proportion is not a metric that we manage to necessarily. We want to say yes to as many consumers as we can, whether that's a repeat transaction or a new one.

Ramsey El-Assal
Barclays Bank PLC, Research Division

And just from a consumer experience perspective, or user experience perspective, does that repeat user -- does their experience change over time as they become more integrated into your -- as they become, well, more repeat customers. Do they get different, better -- do they get more accurate offers? Or do they have access to things? Or how does that experience alter?

Robert W. O'Hare
Senior Vice President of Finance

Yes. We have used frequency as a mechanism for unlocking some new product types within card, in particular, sort of access to different modalities within installment lending would be an example. So things like pay in 30 days or pay in 2 installments instead of 4. I mean, we've used frequency to unlock those.

From our perspective, when we underwrite a new user, we're dependent almost entirely on the data set that we have for that merchant program. But really, in terms of the consumer themselves, we're relying on third-party data to make an underwriting decision. As you progress through your life cycle with Affirm, that credit decision becomes more and more dependent on how you've repaid on previous loans with Affirm, right?

So I think there are some benefits that as consumers prove themselves to be good payers, it does take risk out of the system for us, and we're able to say yes more -- we're able to say yes in different ways. We may be able to lose some things like down payment requirements. So I think there are some benefits as consumers pay us back and as they increase their frequency.

Ramsey El-Assal
Barclays Bank PLC, Research Division

What about kind of transactions per active and engagement? That's also a metric that just trended up over time. What are the drivers there? I'm sure a lot of it is the things you're doing. Is mix also an impact there? What do you think?

Robert W. O'Hare
Senior Vice President of Finance

Yes. I think we're fortunate to have several large programs, which are just sort of naturally lower average order value. And with that lower average order value, we tend to see increases in frequency versus maybe a larger dollar more considered purchase, like a mattress or an exercise bike.

So I think as we've mixed into maybe not every day spend, but more general merchandise, lower tickets, we've seen a nice benefit in frequency. So I think that's the biggest driver. And again, card -- with Affirm

Card, which is one of our biggest direct-to-consumer pushes this year, we do have a pay now feature for sort of everyday spend that unlocks transactions below $50, which historically we haven't touched. And on the margin, as that scales, that will help with both frequency, and it also helps drive down average order values in the ecosystem.

Ramsey El-Assal
Barclays Bank PLC, Research Division

And in the last minute or so here. Just remind us about the Affirm Card, the progress on that product, expectations maybe for the rest of the year.

Robert W. O'Hare
Senior Vice President of Finance

Yes. We haven't really guided anything specific on Affirm Card, but we've been -- it's been really exciting to watch the card scale over the last 12 months. We just crossed 1 million active card users in April. We're really proud of that milestone. And we're seeing -- I think one of the great things to see is that as we scale to a much higher user count, we've seen really consistent behavior in terms of average spend per user when you look at it on a cohort basis.

So I think there was a concern that maybe early adopters might be power users and use it more frequently, and we wouldn't be able to keep that up. But so far, the most recent cohorts have been just as active as the early ones. So that gives us confidence that we're sort of tapping into a pretty large base here.

Ramsey El-Assal
Barclays Bank PLC, Research Division

Fantastic. I think we're just about out of time. Great conversation. I appreciate it.

Robert W. O'Hare
Senior Vice President of Finance

Thanks, Ramsey.

Brooke E. Major-Reid
Chief Capital Officer

Thanks, Ramsey. Thanks for having us.