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Affirm Holdings, Inc. NasdaqGS:AFRM

CFO Fireside Chat

Thursday, September 28, 2023 4:00 PM GMT

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Call Participants

EXECUTIVES

Michael A. Linford
Chief Financial Officer

ANALYSTS

Bryan Connell Keane
Deutsche Bank AG, Research Division

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Presentation

Bryan Connell Keane
Deutsche Bank AG, Research Division

Okay. I think we can kick this off and get started. Hello, everybody, and thanks for joining us today. We're excited to have an Affirm fireside chat with Michael Linford, the CFO of Affirm. So I think that -- well, first of all, my introduction of myself, I'm Bryan Keane, I cover payments, processors and IT services at Deutsche Bank and have been covering this sector for 20 years. I think it's more than 20, but I stop at 20 -- stop counting after 20 to keep my -- keep my age at a limited level here. And so we're excited to go through a laundry list that we put together with the help of retail investors, and we put snuck in a couple of questions for ourself to talk about Affirm, which is a dynamic company to say the least with lots of things going on.

So with that, before we start, Michael, thanks for being with us. Thanks for doing the call.

Michael A. Linford
Chief Financial Officer
Yes, and thanks to all our retail shareholders, who engage in the questions and looking forward to it.

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Question and Answer

Bryan Connell Keane
Deutsche Bank AG, Research Division

Great. Awesome. So I was just hoping to start at a high level. You finished fiscal year '23 and now you are a few months into fiscal year '24. Can you outline maybe some key priorities for this fiscal year? What you're working on and what you're most excited about when you think about the long-term outlook?

Michael A. Linford
Chief Financial Officer

Yes. Long term, we're really focused on continuing to scale the network. The past 1.5 years has been one where we really had to focus on getting our unit economics retooled to the higher rate environment, making sure that we're continuing to invest in long-term growth priorities like the card, but also just manage through what we thought was a pretty volatile economic environment. And as we approach the top of the rate cycle, I'm not sure we're there yet, as we approach it, things start to feel a lot more stable for us, which allows us to return to growing and scaling the network pretty aggressively. And what that means is continued engagement with consumers, more frequency, more reach and also continuing to work on new growth initiatives like the Affirm Card, which we're obviously very excited about.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Awesome. So the big topic on everybody's mind is the macro. I don't know how many headlines I've read that say we're going in a recession, wait we're not going to recession, soft landing, maybe soft landing. A lot of confusion about the macro and where we are, and you guys obviously have your own view and you get real-time data. So maybe you could help us understand where you think we are on the macro and what you guys are seeing in the big picture?

Michael A. Linford
Chief Financial Officer

Yes, we're not macroeconomists, and so we're not going to have a proprietary view, but I can share what we see right now. And what we see right now is a pretty stable environment. You saw inflation kicking on in a pretty meaningful way over the past 18 months and we've really been -- that has responded with higher rates. And that has flowed through the system, we think, in a way that has created now a pretty stable outlook. And so consumer delinquencies are right in line with where we thought they would be at this point, in line with our expectations. We continue to have the ability to control the credit outcomes the way we want, and we continue to enjoy pretty good access to the debt capital markets.

Our recent ABS issuance is a good indication of that, you saw spreads coming in tighter from where they were earlier in this year. And I really attribute that to less volatility. Of course, the Fed will continue to do its job to manage the inflation in the economy and that will continue to create bumps. But I think the big changes that we've experienced over the past 12 months are largely behind us and we feel like we're in a pretty stable footing.

And I think the reason why our credit performance is as good as it is partially that we're very good at predicting and controlling the credit outcomes, but also we continue to see full employment. And as we do see full employment, we continue to be optimistic around what that means for the consumer. And obviously, there's a lot of uncertainty around that particular dimension. And that's why we feel like the need to continue to control duration in our portfolio, so that we can be flexible on how we manage through any particular future credit events. But as of right now, things are very stable because employment still remains very robust.

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Bryan Connell Keane
Deutsche Bank AG, Research Division

If you go back, when did you guys first see kind of maybe some discretionary spend slowdown? And when you guys gave your guidance, it looked relatively conservative for volume. You talked about maybe some negative consumer sentiment. So just trying to figure out where are we in the discretionary piece? And is there -- as we go forward, is that probably going to be at this lower level for your fiscal year guidance?

Michael A. Linford
Chief Financial Officer

Yes. I think predicting what's going to happen into the spring and summer of next year is pretty hard, just given that the macro is uncertain enough there. That being said, we saw, I think, with the whole industry saw about 1.5 years ago, you saw a meaningful slowdown in discretionary spending that also meant that the categories that people were spending on shifted pretty materially. You had the final slowdown of categories that were super high growers during COVID, like everything in the house, furniture, housewares, electronics categories that saw really hyper growth during the post-COVID periods. You saw them slowing down dramatically, and then you saw things like ticketing experiences take off. And that's been the case for the past 18 months.

And again, I think that's why I think of it as pretty stable as we saw that in what we think is an inflation-driven change in behavior along with the post-COVID change in consumer patterns normalize out and that's been the new normal. Alongside that, we also saw what we thought was a normalization of credit that we reacted to and those 2 things combined did put pressure on our growth rate last year. But looking forward, we think things are largely stable, and we're pretty excited about what that means for us for the next year given the work that we've done inside the business, we feel like we can be pretty aggressive right now and put our foot on the gas a little bit.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Got it. Got it. Another hot topic about the consumer is trying to figure out the impact of student loans and repayment of loans. How do you guys think about that as student loans come due and we see some potential impact on underwriting, I don't know, how do you think about the whole student loan repayment?

Michael A. Linford
Chief Financial Officer

Yes, it will definitely have an impact on consumer credit at large. You're going to see meaningful servicing of student debt turned back on that was off for a long period of time. And what that means for us is some subset of consumers are going to be less able to spend money. And that's a real impact. And the cool thing about how we approach underwriting and the depth of data and knowledge we have on the consumers' credit profiles is we feel like we can very accurately predict the level of impact that's going to have. And we talked about on the call -- on our last earnings call, the impact that we had is being extremely low, low single-digit impacts, but already reflected in our guidance. And the way we can measure that is we know the impact on how we would approve or the level of approvals or requirements on down payments and the like for consumers who have student loan servicing turning back on.

And it's not a thing that we have to guess on. It's a thing we can just know. We know what the impact will be. What we don't know for sure is the second order impacts, obviously, as consumers begin to pull back on spending, because student loan servicing comes back on. We don't have a precise way to measure that, but we do have a pretty good way to estimate it for our consumer base. And again, that's reflected fully in our guidance.

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Bryan Connell Keane
Deutsche Bank AG, Research Division

Got it. And then just thinking -- you touched on this, but thinking about how you guys do your underwriting and the credit box in this uncertain macro? How do you think about do you loosen the credit box? Are you tightening? Which way are you guys going depending on what you're recently seeing in the data?

Michael A. Linford
Chief Financial Officer

Yes. I think that it's a pretty unusual set of circumstances for us to be taking a big loosening or tightening step, but it's very common for us to be optimizing the portfolio on a daily/weekly basis and that will continue. And so we don't feel like we have a need to substantially reduce or increase approvals. I think we're focused on making sure that the credit outcomes are in line with the delinquencies that are supported with the unit economics that we've committed to delivering with what our capital partners need. We'll continue to be able to do that and look at any signals in the credit.

If we saw any deterioration in the consumer, we would obviously react to that usually by changing the type of approvals that we're able to extend first, so requiring down payments or shortening duration as an example. And if we saw something materially the other way, we would seek to increase approvals or require less down payments and all the different levers that we have. I'm speaking about them too shortly, but there's a long list of levers that we have to control.

But right now, we see things as pretty stable. And so what that says is that we'll continue to optimize the portfolio daily, weekly, but we are not going to make big moves one way or the other. About the only thing that we've done that's kind of more acute is taking into account the impact of potential student loans, which is fully now reflected in all of our underwriting standards.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Got it. Got it. I want to go into a couple of retail questions. Mohsen in particular, is asking one of the most popular questions in the market these days is how will Gen AI really help to improve the effectiveness of your services? And what are you guys doing now to leverage that?

Michael A. Linford
Chief Financial Officer

Affirm is a data science and machine learning company at its core. We apply data science and machine learning to the problem of both underwriting and front control and we will continue to do that. And I think some people use the word, the tagline AI can mean a lot of different things. And so with respect to data science and machine learning, that's kind of what we've always done. With respect to these large language models and the kind of advanced, the current hot topic in the AI context, there's really a couple of areas that we thought about beginning to use some tooling internally. There's clear impacts. Everything from developer productivity to just internal knowledge management, which we think is a great impact to us, but not horribly specific to what we do.

And then I think on the other side that is exciting is some work that we see in the future around how we will engage and handle customer servicing events and the like. That's pretty far away, though, and I wouldn't certainly think about that as having any super near-term impact on us.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Got it. Next retail investor question I want to ask you from Anshil, who is asking, will Affirm consider introducing

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advertising as part of the revenue model?

Michael A. Linford
Chief Financial Officer

So it depends what you mean by advertising. In our owned surfaces, which include our app as well as our e-mail marketing campaigns, we do have both the ability to generate volume for our merchant partners as part of our integrated relationships as well as to monetize that engagement either through affiliate fees or even paid placement. And it is part of our business today. It is also, though, a thing that we're very mindful of. We don't think that our business is advertising. We think our business is the financial product. We think our business is driving conversion for our merchant partners, all with an eye towards honest financial products for the consumer.

And we've got balance is really important. If we got too unbalanced towards just chasing advertising dollars, for example, we'd lose sight of the core business. And we think our merchant partners want us to be there driving conversion through financial products and not just with creating marketing services. And that's because we do get paid by merchants to drive that conversion. We do get paid by merchants to create those financial products. And it is the case that our product is bought by both the CFO and the CMOs of our merchant partners. But it's important to us that we don't become unbalanced on one side or the other. So you'll see us continue to use our own surfaces to drive conversion and -- where we can. And -- but never in lieu of or in place of the core thing we do, which is a financial product.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Got it. Next question is from Brad, who was asking -- he is from Rhode Island, by the way, I wanted to make that clear, that he's been a satisfied investor this year, but he wanted to ask about will Affirm ever offer a low 0% introductory interest rate for new customers?

Michael A. Linford
Chief Financial Officer

So great question, Brad, and thank you for being a shareholder. I, too, am also really happy with the progress that we've made this year. At Affirm, we definitely believe that anything that is deceptive or subject to change is a thing that we're super conscious to avoid. So, a common thing that you might see in traditional credit cards is a teaser rate that's designed to get you to start using the card and then eventually that rate becomes something very different. And so users, who are carrying balances with those credit cards, will end up starting out with one thing and then end up paying a lot more. Those kind of products we think aren't great for the consumer and those aren't things that we're going to ever do.

However, we have an opportunity to offer because of our underwriting and transaction level approval approach. We have the ability to offer consumers 0% loans all the time, and we do that today. We also have the ability to make the Affirm experience better as users engage more. And our card platform, I think, gives us the opportunity to do a lot of that. And I think that's going to be a real focus for us. Max mentioned on the call, frequency is a real priority for us. And that means that we're going to continue to try to make the Affirm experience better for our users, who are the best users. And those are the most highly engaged ones and we will definitely try to continue to delight them with really honest and yet compelling financial products, whether that's pay now, paying for, pay over time in monthly installments and seek to make that experience as rewarding and delightful as possible.

Bryan Connell Keane
Deutsche Bank AG, Research Division

How do you guys think about CAC and getting customers at the best rate? Is there a secret sauce to your guys' model to

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add customers?

Michael A. Linford
Chief Financial Officer

Today, we largely don't acquire users with marketing. We acquire users predominantly at the point of sale with our merchant partners. So users enter the Affirm network by finding us at the point of sale. We think that model puts us in a really good spot to do what we do best. We build technology products that have a financial component to them, and it keeps us from having to do things that were less great at, which is building large customer acquisition and efficient customer acquisition pipelines.

It sets us apart from a lot of the other unsecured consumer companies, who have a real CAC component to their business model, we really don't. And you've seen us drive pretty significant leverage in our sales and marketing lines in the P&L over the past year, largely because the marketing that we do is focused on building brand as opposed to acquiring users. And those 2 things really aren't connected in a super direct way. Obviously, it's still important for us to continue to build a brand, but we don't think about acquiring users through paid marketing today.

Bryan Connell Keane
Deutsche Bank AG, Research Division

One of our favorite topics along with Max's favorite topic is talk the Affirm Card. It's great to see this product has been kicked off and it's having a strong start I think it reached $70 million in volume in July. And it's obviously got a lot of long runway. So help us frame how to think about the Affirm Card? What we should be excited about and how big this ultimately can be?

Michael A. Linford
Chief Financial Officer

I definitely believe it will be very big. It's obviously early, and so we have a lot of work to do to prove that out. But I really believe this will be the most important thing in the company in 5 years. I think about it as the best experience that we can deliver for Affirm. So today, we can deliver a very good experience online at the point of sale. And our product is highly converting. It's seamless. -- consumers understand it. There's a lot of cognition there. There's a lot of understanding and appreciation for what it is that we're doing. And frankly, I think consumers can get it oftentimes more than some of our institutional investors even, because they're users of it, and it's quite intuitive to their financial state. And that's a really compelling product for larger considered purchases online and I think that is a business that we're going to continue to scale and quite successfully.

I think, in order for us to unlock additional transaction opportunities to mean more to more transactions. We've really got to understand what we can mean more to lower average order value, less considered purchases as well as off-line purchases. And the most exciting thing about the card is it creates a really compelling use case for both of those 2 modes that we largely don't address today in any meaningful way. And that, to me, is the very, very long runway ahead of us. Obviously, offline commerce is still substantially larger than online commerce, even though it's not a growthful and being able to address those transaction modalities offline is really exciting.

The other thing it does is it deepens the relationship with the consumer. The consumer today, our best consumers will continue to use us, whether they find us at a point of sale or start to initiate transactions through the app and that's wonderful, but the opportunity to create a top-of-wallet relationship with the consumer exists with the card. And so by expanding the number of transactions, by deepening the relationship with the consumer and ultimately taking a larger share of their spend, we think we can create a really compelling direct-to-consumer business alongside of our very large integrated merchant business.

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Bryan Connell Keane
Deutsche Bank AG, Research Division

Yes. Adam asked a follow-up question here, and he was asking when can this card be rolled out more broadly? Will there be a push to get the card out even more aggressively in a marketing program or TV?

Michael A. Linford
Chief Financial Officer

I don't think you're going to see us buy a Super Bowl ad or anything like that in the future. But you should see us continue to scale the program. We feel like we have the card dialed in now where we have a really compelling and positive user experience. Those who get it, use it quite frequently and have really strong feedback for us in terms of the positive experience that they have with it. I think there is still some work for us to do in getting users to really understand it at first. It's not like any other product they've used before. It's very different.

I think -- I was talking to an investor recently, and they just fessed to it. They just said quickly, I don't get it. I don't understand this card. And they're not alone - the card is so different. There's really not a model you can map back to, because it is a top-of-wallet card designed to use -- to be used for everyday purchases when you link your account. But it's also a card that when you plan a purchase, you can create credit with, you can actually extend your ability to pay for things over time out of this core product that we have. And that's a really unique way to think about the world.

Credit card companies would like you to start revolving and then get trapped and revolve on your cup of coffee, they want that. And this product is designed to avoid that where you can be very thoughtful around the purchases that do need to be paid for over time versus transactions that should just come out of your account. And that's a whole different way of thinking about the product and those who get it, really get it.

So we're focused on making sure that we continue to offer to consumers, who want it. We'll continue -- you're going to see us continue talking about it a lot and encouraging consumers to try it out, but you're not going to see us force it on users, and we're not in a mode yet where we need to go out and spend a ton of money externally yet. And I think that's because we have a very large base of users, who we can talk to you about the card. We had 16 million active consumers as of the last quarter, and we're going to continue to make it available to them. And there's a lot of consumers who are -- who have used Affirm, who weren't active in the past 12 months, and we have every right to talk to them as well. And so we feel like we still have a lot of consumers to engage with there, and we're going to do that for now and then see where we get it when we're done with that.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Can everybody get the card right now if you pass a certain kind of your guys' credit standards? Can I get it tomorrow if I wanted to or order a card?

Michael A. Linford
Chief Financial Officer

If you've used the Affirm and you're repeat user, i.e., you've successfully completed a transaction, then you can. If you haven't, then you might not be able to. I would encourage everybody to try us out, go download, find us at a point of sale and try checking in with us and then try the experience out. My favorite thing to do is I use the card every day. It's my top-of-wallet card now. And I think it's really awesome to link your account and then always use that single card for every transaction type.

And you have a larger purchase, let's say, you go to the hardware store and you need to buy something for your house

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or your apartment, then you can use the card and say I'm going to chunk that up into multiple payments, either pay in 4 or if I need 3 or 6 months to pay off, I do that, but I also use it for my cup of coffee when I'm at my coffee shop, I can just tap my phone to the terminal and pay for my coffee there and all of that comes out of the same product, and I can manage all that in my app. I would encourage everybody to try it out and give us feedback.

Bryan Connell Keane
Deutsche Bank AG, Research Division

So as a financial analyst, I got to ask you the profitability of the card. We always think about what it means to the model. As this continues to grow, how do we think about the economics of the Affirm Card?

Michael A. Linford
Chief Financial Officer

So today, we have a lot of frequency being driven off of what we call pay now transactions. These are truly debit transactions that are on the card for a very limited amount of time. But the GMV that's processed there is very low. And the GMV is still weighted very much towards our larger monthly installments. So what that says to us is that most of the dollars are sitting on transactions that are true pay overtime transactions that are consistent with our economics and the rest of the portfolio. And because it's weighted by dollars, the economics of the card feel very similar to the economics of Affirm overall. And we've communicated that in our last shareholder call.

I think clearly, as we continue to drive daily spend and try to drive frequency up, that may come down in the future. But as of right now, the GMV dollars are still weighted towards those larger considered purchases. And that's not super surprising, Affirm has always been the tool consumers use to pay for things that they consider more thoughtfully and the Affirm Card product is really built for that in mind. And yet, we, as a company want to drive higher share of consumers' wallets and higher move up the top of wallet position in the card. And so we do expect that to change over time. But as it sits now and for this fiscal year, we expect it to be in line with the total company economics.

Bryan Connell Keane
Deutsche Bank AG, Research Division

And do the economics change or how do they change? I mean, it sounds like the pay now transactions would have less of a margin than the interest-bearing or Pay in 4?

Michael A. Linford
Chief Financial Officer

Yes. So there's 3 products that we deliver to the card today. We have pay now transactions, which are regulated debit interchanges, the revenue model there. And so those are not super profitable. We talk about a 3% to 4% unit economics target. And when you're running on something on the order of 100, 200 basis points of interchange revenue, it's pretty difficult to generate 300 basis points of margin. And so that would be compressing dilutive to the overall margins.

Pay in 4 really has the same revenue model and therefore, has even lower margins, because there's obviously other costs involved. Whereas our interest-bearing product, our monthly installment products that we offer on the card are -- have the interest income on it and, therefore, have really strong margin profiles.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Got it. What about rewards with the Affirm Card or are there any other initiatives you guys will do to try to spur transaction growth?

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Michael A. Linford
Chief Financial Officer

We -- today, we don't have a big reward system on the card, and we will continue experimenting, innovating and deciding how to proceed. What we know is that we want to make the experience for users better over time. And so that could mean things like rewards, it could also just mean financial product availability. And we don't really have a specific thing to communicate externally now, but we are mindful of the fact that we want to be top of wallet and we want to drive engagement. So we're going to try to make the experience as delightful and rewarding to the consumer as we can, consistent with the economics that we know we need to deliver.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Got it. I wanted to jump to another retail question from Bhargav, who is asking, he saw some headlines about maybe a subscription model. Is that true that you guys are looking at subscription models and how would that improve the company's value proposition?

Michael A. Linford
Chief Financial Officer

It's really interesting, the story that broke because people were looking at the source code at our iOS app. And one of the things we've said in other places, and I'll say here again is I would really not put a lot of weight on trying to figure out our product road map based upon things like that, because we're out experimenting stuff all the time. It's not uncommon for even consumers to see a live test on things that are truly just a test. And what's interesting about that is if you look at the Affirm Card itself, it is a function of a lot of product innovation that happened years ago at Affirm that we shelved, because we couldn't figure out a way to make the economics work.

And what we do at Affirm, we'll get an idea, we'll go out and test it. Sometimes we'll even build a product and get it into the wild. And sometimes it doesn't work. Sometimes it works really well and we scale it. Sometimes it doesn't work and we either shelve it or we take pieces of it and build on it. And that's been in our DNA since day 1. And so I think it's a mistake to look at any one feature you might see on a given day or week and assume that's where the strategy is headed.

That being said, like I said before, we are focused on making the Affirm experience better over time, and we'll continue to want that to be a priority for us. And so whether that looks like additional features or product availability for consumers, we're going to keep that going. But yes, there's definitely nothing specific around subscriptions to talk about here right now.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Got it. I wanted to ask about your success with recent large partnerships. I mean the 2 big ones that come to mind are obviously Shopify and Amazon and in fact,Vivek is asking a question here. How -- what have you learned so far the payments on partnerships? So maybe you can talk a little bit about Shop and Amazon and how they've gone versus expectations? And where do you expect maybe growth and scalability of those contract as we go into this fiscal year?

Michael A. Linford
Chief Financial Officer

We signed our Shopify deal, I think, in 2020. It was something that we announced publicly, I think in middle of 2020. Obviously, when we were going public, we talked to a bunch of folks about it. And keep me honest, Bryan. I think it was

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like question 1, 2 and 3 that we got asked on every call for the first 6 months until it went to GA. And what we said a lot back then is definitely true, and it's worth repeating here, which is these very large partnerships take a lot of time to scale. It is not the case that you turn on the partnership and all of the value happens overnight. So much of what we do requires scaling the partnership up, working with the partner to design good customer experiences to drive the conversion that we want, optimize the experiences on the site and continue to iterate the product availability.

And so we did that with Shopify, and we're doing that with Amazon, and we'll do that with any large partner. And the key learning for me, that is definitely true across all these partners is that when we are able to get the kind of partnership or relationships that we have there, it creates a lot of work for us over time and it's not something that happens overnight. What that means is that the impact to the company, to the medium term is really strong. And I think it's evidenced by the fact that some of our partners are actually accelerating their growth right now despite being several years into the relationship. And so you would expect the growth rate to attenuate and even decrease over time, and yet we're seeing some real acceleration there. And that's a function of the fact that there's just a lot of work to do.

Affirm was on the order of 2% of U.S. e-commerce over the last year. And while that number is super shocking to me, to be honest with you, from where we were 5 years ago, it's also still really small. And so when we think about our penetration on these platforms, it's still really small, and we have a lot of wood to chop, so to speak. A lot of work to do ahead of us to continue to get our share there. And when we look at other markets and some of our largest shares of cart, we say that we have a lot of work left to do. And because these partners are so big, we have an opportunity to continue to work on them and scale the business completely independent of the work that we have away from them, which continues. We continue to engage with net new merchants and channel partners to continue to scale and distribute our network out. And that work will continue. And yes, we still have work to do to grow with our existing partners in a pretty material way.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Got it. What about inside of Amazon? Will there be -- do you guys think there'll be other BNPL providers? The question we often get is competition in the space. Do you expect others to be also to grab some of that share since the BNPL pie is growing so rapidly?

Michael A. Linford
Chief Financial Officer

We expect competition everywhere. The thing we like to say is that whenever you have these kind of major shifts in consumer preferences. And make no mistake, we believe that the category of these alternative credit products, BNPL or whatever you want to label it. We think that is a fundamental shift to consumer preferences, away from revolving credit accounts and towards safer and better financial products. And that, we think, is a trend that we helped create and we're helping reinforce, but definitely would have happened without us. And I think that means that we will continue to see competition attracted to the category, because any time consumers are goading with their wallets, people are going to want to get into those categories and our mindset is never that we will rely on having a contractual exclusivity in order to not deliver great products.

We win by delighting the consumer and helping the merchant drive conversion. And that has always been the case and will always be the case. And so when we think about any of these large partners, we don't really put a premium on the contractual exclusivity. We -- obviously, we'd never avoid it. We think it's great when the merchants want to work with just us. And yes, we don't need it. And we're happy to be marketed alongside other products, because we know that our users really love us. And we provide a really unique set of products.

And maybe the last point here is while there are a lot of players, who are in the space more generally, there's very few players who can do the breadth of products and the quality of underwriting that we do. It's really difficult to do what we do. And because it's very hard, it's worth doing and because it's very hard, there's a real difficulty for a lot of players to

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catch up to us. I think the reason why some of the largest platforms and merchants out there haven't chose to partner with us is because it's really hard. And they looked at the problem and understood it as being one where we had a pretty significant lead on anything they could do on their own.

Our largest partners aren't intimidated by any problem. They are capable of tackling the world's hardest problems and yet they choose to partner with us. And I think they choose to partner with us because what we do is really hard. And what we do is really hard and we're uniquely good at it. There's certainly products out there like the pure play Pay in 4 providers, who, I think, provide a great pay in 4 for experience that they lack the product breadth that we have and that really has suited us quite well, especially in this current rate environment. In this current rate environment, it's difficult to put the entire responsibility on the merchant, the ability to build a program with consumer revenue sources in the model has put us in a really strong spot.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Got it. No, that's helpful. I understand that competitive dynamic is that always comes up a lot. Thinking about Amazon and the business mix, can you talk a little bit about that, because there's been a portfolio shift more to the interest-bearing loans, compared to the 0% APR offerings. How that impacts the P&L and any funding issues or credit issues to think about as that shift takes place?

Michael A. Linford
Chief Financial Officer

Yes, there's no funding issues related to that. Obviously, the 0% loans have a different kind of motion in the capital markets, there's revenue source in the loan. And so if you sell them, you're selling them below par and you're making the difference up hopefully in your merchant discount fees. So there's a different motion to it, but the investor appetite for the loan, given that we can structure it however we like, it remains really strong, whether that's a 0% loan or an APR carrying loan.

I think the bigger thing that has happened is the category shift that we talked about before, where consumers spend a lot of time during COVID and immediately after filling out their home with exercise equipment or home office equipment. A lot of those purchase modes were categories that had the margin structure that allowed for 0% financing proposals and the like. And as we've seen a shift towards slightly more general merchandise and a broader category mix, you've seen merchant margin profiles that simply don't have the capacity to fund the 0% programs the same way. And again, that's not a sort of bug of the program, it’s a feature. We're able to do both and do both quite well.

When we were going public, a lot of folks were concerned around the concentration we have with our largest partner at the time. And we deconcentrated out of that and now have a different mix, but neither one was good or bad. It's a reflection of the fact that our diverse product set can really hit the consumer with where they're at. And right now, the consumer tends to be in the categories that allow for those interest-bearing products, and we're happy to meet those. But we expect that would continue to change and evolve over time.

In terms of margin structure, they're really similar. The way in which it flows through the P&L is very different. Our 0% loans tend to have a lot of merchant discount rate and tend to have higher funding costs over the life of the loan and obviously, no interest income from the consumer. Whereas the interest-bearing loans tend to have less duration, tend to have interest income in the loan. And so they look very different, but they net out to really a similar spot.

That's one of the things at Affirm that we've done, I think, a very good job of over the past several years is we've held a pretty strong line on making sure that we deliver the unit economics that we need to deliver. And we do that both because we're a business and we need to deliver the margin structure that we need to, to support our expenses, but also because our risk management approach dictates that we need to be underwriting for through-the-cycle credit

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performance, and that means that we need to be able to withstand changes to the credit environment, and that has served us very, very well over the past 18 months.

Bryan Connell Keane
Deutsche Bank AG, Research Division

So as the portfolio evolves and the economy strengthens or weakens, will that determine typically from 3 to 5 years from now what % would be interest-bearing or 0% versus the other sources?

Michael A. Linford
Chief Financial Officer

I think the macro has an impact on it. I think the merchant mix on our platform has a big impact on it. And I also think the rate environment has a big impact on it. I think that when rates were 0, the cost of 0% financing was lower. One of the things that we've done a lot of in the past year is introduce what we call fixed APR programs with merchants and these are 5% and 10% APRs and the idea behind these is that while we want to offer a really compelling cost of financing, it just can't be 0% in this rate environment, because the merchant doesn't have the capacity for that.

And so our ability to do that is differentiated. And again, it's our flexibility in breadth of product on display. But also, it's a reflection of the macro environment. And if rates go back down to 0%, I would expect those programs to go back to 0%, but we're not expecting that. We're not expecting a 0% rate environment anytime soon, which means, I think, we're settling into just slightly higher mix of APR-bearing loans for the time being. And I think when rates were 0% and people can get a mortgage at 3%, it was a neat feature, but it wasn't super compelling to have a 0% loan, and the 5% APR loan wouldn't be all that interesting.

Now we're able to offer products that still have a really compelling rate attached to it. I think consumers are slowly coming around even the ones, who were pretty averse to the idea of interest, are coming around to the fact that money is worth more now. And in a higher rate environment, everything that we do is worth more. And that means that some consumer APR is acceptable to the consumer, and we've seen that show up in all of the pricing work that we've done. But we've been able to really effectively manage the APR mix of the platform and not impact the volume in a negative way.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Got it. I want to go to a retail question from Donald. I'm going to paraphrase this question, where he's basically asking how much remaining funding capacity does Affirm have or you're unable to make loans are required to slow down the GMV?

Michael A. Linford
Chief Financial Officer

So we're always built ahead of where we need to be. Our capital team, which I've said before, and I'll say again, we have the world's best capital team. They source capital for us ahead of where the group needs to be. And we did that last year when there was a lot of economic volatility. I mean remember, over the last year, we saw rates going from 0 to 500 basis points in the blink of an eye. You saw banks failing. You saw continued economic uncertainty from global conflict. It's been a rough and a very volatile economic period.

And despite that, we added the capital we needed to scale the business. And we do that with net new issuance in the ABS market, signing up new bilateral agreements with forward-flow partners and, of course, adding warehouse line capacity with the banks. And we've been able to do that in that in the past 18 months of economic volatility and feel

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really confident in our ability to continue to do that. You saw us do our ABS deal, I mentioned at the top recently that added a great deal of capacity. It was a deal that was tighter than where we were at earlier this year. The demand and appetite from investors was very large. I think both because we've really done a lot of work to engage them and help them understand the quality of the asset that we create. But also that the actual results have been great.

We talk a lot about our risk management approach and our -- on our credit outcomes that were driving the business and they're really good. And I think investors 1.5 years ago, we're very worried about where those might end up and because we've managed the business so well over the past 18 months, I think investors are beginning to really differentiate us from other unsecured consumer assets that they have the opportunity to invest in and that really suits us well. I think the fact that we're also approaching the top of the rate cycle, whether we're there or will be there soon, I don't know. But the fact that we're approaching it does mean that a lot of the posture from the largest asset managers is really interested in credit. Credit right now is an asset class that I think is getting a lot of attention and we're the beneficiaries of that.

So Donald, I think the answer is we feel really strong about our ability to continue to grow. We don't feel like capital is a constraint on our business today. Our capital team always carries 3 priorities. And priority 1 is to enable the growth of the business, and we've never violated that.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Yes. I was going to ask about funding going forward in this fiscal year, where do you think some of the funding sources? Or how will the mix change? And I think you talked a little bit about it on the call that you guys will be a little more on the warehouse facilities. Just any color on forward-flow partners and securitization market? How do you wrap it all together and decide where you're getting the funding.

Michael A. Linford
Chief Financial Officer

We're getting all of it. We're focused on scaling in all of our channels. And again, I think the conversations with investors these days is a lot more constructive, not because it was unconstructive before, but because there was just, I think, a pretty healthy uncertainty or volatility premium that was being paid in the market. And again, if you look at the ABS execution, spreads coming in tighter despite rates being higher, does suggest that there's a little bit of a premium we're paying that is beginning to normalize out, and that's really healthy for us.

In terms of mix, we'll continue to scale all 3 channels. You saw, again, the ABS issuance, so you will see more ABS issuance that ends up on the balance sheet for our revolving deals. So those are consolidated deals. And so it will look like loans on the balance sheet, even though they're sitting in securitization vehicles. We will continue to add net new partners in forward flow and upsize the existing partners. Our conversations with them, from my perspective are super constructive and we have a really high-quality list of loan buyers buying our whole loans.

And the banks are, I think, definitely interested in continuing to expand capacity or expand the capacity we have in the warehouse lines. I think it's obviously a business for them that is a very good business. It's important to us, and so I'm appreciative for it, but it is a good business for the banks to think about the quality of credit outcomes that we're driving. I think even banks, who are generally not excited about unsecured consumer assets were at large, know that Affirm is a pretty good manager of the credit outcomes. And therefore, their posture tends to be one where they're interested in helping us continue to scale our platform.

So I think you're going to see scale across all 3 channels. On any given quarter, you might see us dip into one or the other more just because the timing and onboarding of these things is it's not something as just snap your fingers. We add a new forward-flow partner. It can take quarters of negotiation before we finally get them ongoing. We can, of course, fund that thing very quickly once we get it going, but it can take us 6 months to negotiate a deal. And because of

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that, we do have pretty good line of sight to what we think the pipeline is. And like I said before, the best capital team in the world, and they're doing a great job in engaging that investor base.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Got it. I want to ask a couple of questions about the fiscal year '24 guidance. In particular, your revenues and revenue less transaction costs (RLTC) is a number we look at quite a bit as a percentage of GMV will stay relatively flat in fiscal year '24 as a percentage. There's moving pieces though, I mean, it depends on if it's interest-bearing or how things are getting funded. Can you just talk about the stability you expect in those 2 line items as a percentage of GMV, which is revenue and RLTC?

Michael A. Linford
Chief Financial Officer

Yes. So on the revenue side, we have continued mix changes in the business where you're going to see the phenomenon we talked about earlier where the interest-bearing loans and 0% loans are going to continue to play out on the P&L. And of course, you have the ever present confusion or complication where our funding strategy dictates the timing of recognition of revenue, because we earn revenue for loans that are on our balance sheet over time. And of course, we earn revenue for sold loans when we sell them.

So you have those 2 factors kind of mixing in there and then you have -- sorry, in addition to the consumer APR work that we've done driving up the total asset yields. You also have -- on the revenue less transaction cost side, you have a higher rate environment. We've been digesting the higher rate environment, because as I mentioned before, we kind of fund ahead of growth that serves to dampen some of the rate impact in the near term and we're going to continue to see the impact flowing through of higher rates.

And so that will work as a headwind, but some of the revenue points above also mean that the kind of asset that we're generating will be a little bit different, allowing us to offset those other costs elsewhere, either in the servicing and processing costs or in the duration of the asset driving down funding costs on a unit basis. And those things allow us to kind of dial in the units that we need and I think it's a more technical description of how the P&L is working. I think the better way to think about it, if you just step all the way back is that we feel like the world is going to be pretty stable and the world is going to be stable, then we're going to be able to generate the same economics as we did last year.

Bryan Connell Keane
Deutsche Bank AG, Research Division

The guidance, you guys talked about volume, GMV volume being greater than $24 billion, which is a slight tweak of how you guys used to talk about GMV volume. Was that due to just economic uncertainty? Or is that due to the Affirm Card ramp? Or is there something else in there why you decided to go with greater than instead of a range of outcomes for volume?

Michael A. Linford
Chief Financial Officer

Well, I think, to be honest, the past 18 months of volatility has taught us that we should be very thoughtful around how and where we provide guidance. And I think we felt last year like it was going to be a really difficult thing to predict into the 12 months from then. And yes, we still provided the guidance, and I think I wouldn't have done that at the time machine. But we did. And I think going forward, what we want to do is try to get investors out of the mode of thinking about like whether it's $24.132 billion or what and zoom out just a little bit and focus on the longer term.

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What we're really happy about is the way in which this network has scaled. From where we were 3 years ago or 5 years ago to where we are today are leap changes, step changes in scale, we've leaped forward in network size and engagement. And that's what we want people to focus on because that's what we are focused on internally. And hopefully, our approach to the full year guide, let investors know that we're not trying to dial in within $50 million of GMV for the year. And instead, we're focused on scaling the network.

We did still provide the same guidance the quarter because obviously, we have a good feel where the quarter is going to be, and we'll continue to do that. So we keep investors abreast of the detailed ranges we expect in any given quarter. But for the full year, we're trying to get folks to think a little bit longer term and do math just a bit.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Back to some retail investor questions, Donald is asking another question, just asking about profitability of Affirm. When does it plan to make a profit? I guess -- you guys obviously guided for adjusted operating margin to be north of 2%. But can you talk about profitability and scalability of the model on profits?

Michael A. Linford
Chief Financial Officer

So very happy that we got to adjusted operating income profitability last quarter. And we talked briefly about what that means, because it's a lot of words there, and then why we look at that measure right now. So when we think about adjusted operating income, the primary things we're adjusting out relate to stock-based compensation and the warrant expense with our largest platform partners.

We adjust those out for 2 reasons. One, they're noncash. If you think about the nature of those 2 expenses, they don't hit the cash accounts, because their stock or warrant expenses. And secondly, they're really volatile given the way in which we do those valuations. Those are always valued at the time of the grant. And given our stock volatility, they're just kind of decoupled from the dilution that an investor might actually experience. And so we take those out and put them to the side. They're also -- for at least the platform partnerships, they're not really addressable in a way that's good for the company. We don't obviously want to discontinue the relationships. Those are good things. And because those things are already done, there's really nothing we can do to address those costs.

So we take those costs out and we look at the rest of the business, and our goal was to get to adjusted operating income profitability and we did that in our fourth quarter, and we guided again to the full year in that range. We do expect any given quarter to bounce around a little bit, but do expect on a full year basis to continue to deliver adjusted operating income profitability.

I think as investors digest that and get comfortable with that. The natural next question is going to be when we achieve GAAP profitability. And that's a few years away. We need to get through all the warrant expenses before we would expect to deliver that. And again, I don't think that shareholders should want us to reduce those warrant expenses, because the only way you can really do that is to discontinue those relationships, and obviously, those are very valuable to the shareholder. And so we're not focused on trying to reduce that number. We're just trying to operate the business and make the most of those partnerships that we can, and we'll continue to do that.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Got it. I wanted to turn to Skyler. He had 2 questions, a retail investor here. He wanted to ask -- he's asking about differentiation of Affirm to other BNPL competition. We talked about that a little bit – the competition. But maybe just how Affirm is different than when you see Apple pay, make announcements that they're coming into the marketplace. And

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then two, he's asking about new opportunities for growth in international expansion, is it some other product lines that you guys plan to go to beyond what we've already talked about?

Michael A. Linford
Chief Financial Officer

So the second question first, what we've already talked about is really big. We have a lot of work to do. As I said before, our existing partnerships, obviously, we have a lot more work to do to penetrate them and as we scale the card, we begin to address offline commerce, which is significantly larger than online commerce. And so we feel like there's a lot of growth to do even before you start layering on other things and yet as I said that before as well, the best thing about my job is getting a partner with one of the world's best product thinkers in financial technology in Max. And he's definitely not done innovating, and so we're going to keep building new products and tackling new opportunities. But there's a lot of growth in the stuff that's already out there.

In terms of how we think about competition, again, I think we've always expected that when consumers are kind of creating a big shift and they're moving away from one very popular mode, revolving credit cards and they’re moving to something else, we would expect there to be competition. People don't look at these big changes and let somebody like Affirm just take the market, we expect there to be competition. And so that's unsurprising and unintimidating to us. So we welcome the largest entrants, they help validate the category. We think they're in the category for the same reasons why we are, which is because these consumers are ultimately demanding it.

We think about differentiation versus those players based upon the kind of network that we built and the kind of products that we offer. Our network is integrated with the merchants at the point of sale, driving better conversion for those merchants in a way that some of the entrants to the category don't do. And our breadth of products is differentiated. We can do very short-term payments. Now with the card, we can even do pay now. We can do pay in 6 pay in 4. We can do 3 months, 6 months, 12 months, all the way up to 48 months in duration. And these -- the breadth of products that we offer, combined with the kind of network that we're building is truly differentiated. And so while competition is here to stay and we definitely think the world will be competitive as long as the consumer continues to prefer these alternatives, we for us think more internally and making sure we build great products, great experiences and the best network possible.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Got it. We're almost out of time, but I do want to ask you about the upcoming Investor Day in mid-November. Maybe you could just give us a high-level preview on what might get addressed in the Analyst Day?

Michael A. Linford
Chief Financial Officer

I'm definitely not going to leak any of the content ahead of our Investor Day. We just want to take a minute outside of the normal, you have this quarterly process that we go through, and there's a lot of discussion on the quarter and the guidance and all these technical aspects. And it's a really important part of how we engage with investors and analysts. We want to take a minute and step out and talk about the business where we're at, the long-term growth and trajectory that we're on with all of our investors and the analyst community. And so we'll be doing that in November and really excited to share more details as we get closer to that event.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Any thoughts on long-term targets or updates to the long-term targets? Usually on an Analyst Day that's the potential nugget that gets thrown out there.

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Michael A. Linford
Chief Financial Officer

I would encourage everybody to attend and engage in November to see what we have to say then. I really don't have anything to add today.

Bryan Connell Keane
Deutsche Bank AG, Research Division

Okay. All right. Great. Well, thanks so much, Michael. That was awesome. Thanks for the update, and good luck going forward here. And we'll be watching you every step of the way.

Michael A. Linford
Chief Financial Officer

Thanks, Bryan. Cheers.

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