Podcast Transcription Session 39: Al Goldstein

Peter Renton: Welcome the Lend Academy Podcast Episode number 39. This is your host, Peter Renton, founder of Lend Academy.

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Peter: Today on the show, I am delighted to welcome Al Goldstein. Al is the CEO and Founder of Avant. Now, Avant may not be a name that everyone recognizes, but I am sure that everyone will recognize them very soon. They are becoming a force to be reckoned with in this industry. They only wrote their first loan less than two and a half years ago, but, recently, they just crossed One Billion Dollars in total loans issued, they are the fastest company to that milestone in our industry's history. So we wanted to get Al on the show, talk about Avant, where they fit, who's the borrower that they're targeting, how they're able to scale so quickly and just dig, actually dig into some of the details about their underwriting process, about fraud detection and, of course, on the investors' side because the recently opened up their market place to outside investors and his thoughts on balance sheet versus market place investing. I think it was a fascinating interview, fascinating company, Avant, I hope you enjoy the show.

Peter: Welcome to the podcast, Al.

Al Goldstein: Thank you, Peter, thank you for having me on.

Peter: Okay, so let's just get started with giving the listeners a bit of background about yourself and what you did before you started Avant.

Al: Sure, well, I started my career as an investment banker probably about 12 years ago and I did that for all of 12 minutes until I figured out that I was probably a terrible corporate employee, no one should even hire me.

Peter: Right.

Al: Well I've been very fortunate to have now been a part of three businesses in different industries that have all kind of done very well. I actually started my first company when I was 23 which was in the early onset of the online lending space. The company now is a public company, we started it in late 2003/early 2004 and selling it to a public company and then it got spun off by itself and is a public company now which is great and business has done phenomenally well.

We did that at the end of 2008 so we had some spare time and my business partner who now is one of my board members at Avant and I started a company called Pangea Properties to invest in real estate and at that time this was distressed real estate, but really the premise was to bring a sophisticated approach to manage and operate some hundred units apartment that are scattered side. That business has done really, really well so very different physical real estate where we had to build operational scale.

Then there was Avant and so we started Avant about two and a half years ago with two co-founders who were actually my former interns at my first company so it's really come full circle.

Peter: So tell me about why.....I mean, you're doing a real estate thing, I mean, why decide to start Avant? What did you see as the hole in the market that you're trying to fill?

Al: Well, I think like a lot of companies that came out of a frustration……what happened was my two co-founders were actually Y-Combinator at that time building a different company and one of them went into a physical branch to get a loan because they were building a business and clearly didn't have any income coming in. That process was so incredibly excruciating for him. Well we were talking about what to do with their business and what to do next. We just saw a huge opportunity in the market to really provide a better alternative, better pro financial products to middle class consumers. At that time Lending Club had done really well benchwise, the whole category, but we didn't think anybody was really focused on 40 or 50% of people that are underserved and in the middle class.

Peter: Right, so you went straight right out of the bat which.......obviously, Lending Club and Prosper go after sort of more of the prime borrowers that hasn't been your focus. So can you tell us who is a typical borrower at Avant and what are they using the money for when they take out a loan?

Al: Sure, people at Avant....our mission is really pretty straightforward. We want to be the best provider of financial service products in the world for people that make between $40,000 and $85,000 a year. We define those people as middle class in the US. The income shifts as you go to other countries and that's very different than the traditional borrower from Lending Club or Prosper, etc. Our average borrower makes about $50,000 a year, they have an average of 650 FICO and they're highly diverse, but what they're using the money for is really a hybrid of debt consolidation but it's now with credit card debt and half the time, it's just access to credit because they're not getting access from the traditional banking world. It's for things like home repairs, auto repairs, medical bills, education, vacation, you name it.

Peter: Okay, so then I imagine these are a little smaller in loan sizes than we're used to at Lending Club and Prosper which are in sort of the $13,000 to $15,000 range. I mean, what's a typical loan size and what kind of terms do you offer your borrowers?

Al: Yes, so our loans are about half the size of the typical Lending Club/Prosper loan that you mentioned, an average of about $7,500 to $8,000. Terms range from two years to five years, an average being around four years and we have rates ranging from 9% to 39%, with the average being in the mid to high 20. The main difference for us with our products relative to some of our competitors and I think this is quite unique is that we don't charge any upfront fees to our borrowers. So when you take a loan from us......if you borrow $10,000, you're only paying interest on $10,000 and if you pre-pay that loan, you only effectively pay interest on the amount of time that you have the loan outstanding which is a unique benefit for the consumer.

Peter: So you just make your money then...business model for Avant is making money on the spread of the interest rates, I mean, is that ...that's your only source of revenue?

Al: No, so we view ourselves as a true online loan platform where we started as a peer direct lending company when we were building up history for our portfolio making sure that we can underwrite consumers very effectively, but today, roughly half of our loans we make directly and hold our own balance sheet; the other half we actually sell to investors at a premium. So we don't charge the consumer the fee, we just allow investors to bid the premium up and that way they can buy that loan at a premium, collect the interest over time and that's how they get to their effective yield.

Peter: Okay, okay, that makes sense. So when we chatted last year, you mentioned that the minimum APR was I think down to 20%, now it's just under 10% so sounds like you've made a pretty significant adjustment in your interest rates. Why are you doing that?

Al: Our goal is to offer the broadest array of products and terms that we can to our consumer segment. Largely, we couldn't offer rates that were too low because our cost to capital was just too high and at that time we didn't have investors that were able to buy loans off of our platform.

We now have been able to solve those two problems by having cheaper cost of capital per loan that we hold in our own balance sheet and having investors that are willing to buy loans off of our platform which now we have roughly $600 Million of institutional commitments to buy loans off of our platform that's going to double over the next couple of months.

So you're going to see us over the next three, six, nine, twelve months lower our rates so we'll be able to offer products that are cheaper to the end consumers that has the best credit profiles, offer more products that are differentiated, that are not just the unsecured personal loan products and see an expanded geography.

Peter: Okay, so someone's at 650 FICO and they came to your site a year ago and they come to your site today, are they paying less interest?

Al: Our philosophy is really pretty simple. FICO is one of the credit parameters that we look at, but it tends to make up less than 5% of the value of our predictive models. So on the average that's probably true, but that's largely given the make up of our customer segment because the way we think about it is you come to Avant, we will look at all of the data that we have available today. From a credit perspective, we're going to look at over a thousand individual variables. Based on the outcome of our predictive modeling, we're going to give you the best risk adjusted rate that we can and that will likely depend on what your credit profile is. One 650 FICO will likely get a very different rate than another 650 FICO.

Peter: Right, right, fair enough. But if your average is 650 and you, obviously, got a lot of borrowers up around the 700 mark, I imagine, which is........that's standard in the territory where Lending Club and Prosper play, they've got an average FICO just over 700, do you see those companies as your competitors when it comes to borrower acquisition or who are you competing against?

Al: I think Avant sits a little bit in the middle, again, because at the core we are focused on middle income consumers so we do overlap with Lending Club and Prosper and the like a bit as we get about 680 FICO which is roughly 20/25% of our consumer segment today. I think it's going to be good to be more, but I think we're all fighting lack of awareness. At this point, collectively, we're such a small component of the overall market that if all of us just brand awareness in providing better products to consumers rather than individual competition between us and Lending Club.

Peter: Right, right, fair enough. How are you acquiring borrowers today? Do you have a mix of direct mail online, what are your major channels?

Al: The acquisition channels are just highly diversified. We do online and offline partnerships, we're going to focus a lot more on partnerships over the next 12 months and you're going to see us announce some offsetting partnerships shortly and that can be both with banks and non-banks. We are very strong with digital marketing, social media, we have lots of referrals coming to us from existing customers that have had a good experience. Direct mail makes up between 10 and 15% of our total volume, we think is a great channel. We really believe in expanding our channels. You're going to see us do more offline media like radio and television and really build our brand which is really the long term goal.

Peter: Okay, okay, so what about mobile, I mean, is that a major part? I mean, what percentage of your borrowers come to you over the phone, over smart phone and how important is that to your business today?

Al: I think mobile is the future and it's all about meeting with mobile and creating a better customer experience. 60% of our borrowers actually come to us via mobile phone or mobile application today.

Peter: 60%?

Al: Correct, six zero, that's the majority of our customers and we just rolled out our first mobile app in the Apple iStore recently and it actually geared towards existing customers, but you're going to see us evolve that to really be an app that allows brand new customers to do their full application and manage their entire process online and roll out an app on the android store as well so we grasp mobile as the future. In the US that's clearly the case, but as we go to more international markets, especially some of the developing markets over time, it's all about mobile.

Peter: So if your folks are existing customers, what does your app do today that would interest your existing customers? Is this purely just trying to get them to repeat, to take another loan, what does it do?

Al: Today the application allows people to manage their account through the verification process to know exactly what parts of the verification process they could revisit, or may need to complete and they can manage their accounts and their payments online so they can move their payments around, schedule pre-payments if that's what they want to do, request to refinance, really putting the power in the consumers' end and going forward, it's going to be the full application flow, full application process and more tools and features.

Peter: Okay, okay, so I want to switch gears a little bit and talk about your underwriting process. You mentioned on your panel at LendIt that.....you said 50% of borrowers today are going through a completely automated process when it comes to underwriting and you said you want to get that up to 90%, I think you said, can you tell us how you're able to do that and what kind of processes you're using?

Al: Sure, at Avant we really differentiate between two processes side by side where we have a credit process, where we come up with an automated credit decision for all of our consumers that is defined and not something that any human can change and then a fraud and identity process which tries to make sure to the best of our ability that you're not the subject of identity theft; you, in fact, are the person that's applying for this loan. The way those processes work on the credit side, we're trying to get as much data as possible to come up with the best answer for the likelihood of longer term performance and, therefore, that translates to your dollar amount, your grade you're going to be charged, your payment scheme, etc.

On the fraud and identity side, we're using as many tools and pieces of data that we can find in conjunction with very sophisticated processes that use machine learning algorithms to try to ferret out the people that have a higher likelihood of being fraud and not being who they say they are and those are the people that we're looking to manually verify.

So as we continue to improve our processes on the fraud and ID side, those are the people that will be able to automatically shuffle through the process and our view is that's what the customer really wants. So the customer wants is an instant answer because we live in a world of instant gratification to be able to use the mobile phone. The fact that we can give you a real time answer, you're going to enjoy that experience so much more.

Peter: Okay, so just help me work through this. I mean, someone comes along and just say they're an upstanding citizen, there's no red flags and they're part of the automated process; they get an instant answer and when do they get their money?

Al: The next business day.

Peter: Okay, they agree to say yes, I want this loan and then you're just doing an ACH with them the next day?

Al: Yes, the customer will have to agree to receive the funds we electronic deposit and upon that agreement, assuming that we are before the cut-offs for that day, the funds will just arrive on the next business day.

Peter: Right, okay, so I'm guessing right now you've got 50% of the borrowers are being flagged in some way and some human being will actually look at them, how long is that going to take for the typical....that human intervention to get....how long will the approval process take?

Al: For us, virtually all applications are processed within 24 hours and the best majority of the applications are processed within 30 minutes. 50% of the applications we talk about are processed in absolute real time. What our goal is, is to get to the point where 90% of the applications, like I said at LendIt, are approved or declined in real time and only 10% of the applications have a manual processing component. The only reason that processing component can take longer is because we're waiting for borrowers to do something on their side.

Peter: Right, right.

Al: We're going to get to move the applications very quickly, but we may be looking for a borrower to submit some more information that they didn't submit, connect their bank account, etc.

Peter: Okay, okay, so then obviously fraud is really high up on your agenda for future automated underwriting. What have your experiences been of fraud? I mean, I know that it's a huge focus at the other major platforms as well, I mean, how much fraud is there on your platform today?

Al: So we have a lot of attempted fraud as you might imagine given the fact that we are in the business of handing out money to potential borrowers. Well, we've actually had a lot of experience in stopping virtually all fraud where in the first billion one, billion two of loans that we've written we've had roughly $200,000 of total fraud that we funded that confirms that tiny percentage and we're very proud of that percentage and largely, that's due to the certification of our fraud processes and we continue to invest in those processes.

Peter: Right, right, that's quite impressive. So what about defaults? I mean, you're operating in an area of the market where people's jobs typically aren't just secure....they might take a lot longer to get another job, how have defaults gone for you? Can you give us some sort of idea on the numbers, of an overall annual loss rate?

Al: Sure, the way we think about default in the market, it's all about the risk adjusted return, risk adjusted yield where our average gross rate to the consumer may be in the mid to high 20s. On the average, we have roughly 10% annual delinquency so whatever your gross rate is if you take out 10% that's roughly the net yield from those loans and that does seem quite consistent.

The other view is that for people that have less variability, that are higher credit quality consumers, they get a lower rate. You'd expect there to be very little delinquency for people that have a higher yield that are more variable, have higher potential delinquency so it's all about really allocating the right risk to the right customer.

Peter: Right, right, yup, fair enough. So let's talk about your investment partners now. You launched your market place just before LendIt, you had some marquee launch partners KKR, Victory Park, Jeffries...so can you just tell us a little bit about how the market place is working. You mentioned you got $600 Million in demand, I mean, are these entities investing just across your platform, are they sort of giving you a credit profile of the kind of borrower they want and you just find loans to fit them, I mean, how is it working?

Al: So, the Avant market place is set up to be randomized and so the idea that neither Avant and our own balance sheet nor any other investor can front run or cherry pick selective loans in a given tier. So if you want to buy our A loans, our B loans, our C loans, they will look just like the key loans that we hold on our own book and the loans that anyone else is buying at that tier will get to buy which we think is extremely important from a longer term conflict of interest and transparency perspective.

As you mentioned, we launched with three great launch partners, we actually are in the process of doubling that $600 Million of capacity. Over the next couple of months, we're launching with Orchard and will allow investors on the Orchard platform to buy Avant loans which is going to create a lot of diversification in our institutional buyers and at some point we really are excited about creating vehicles for high net worth individuals to be able to buy our paper. So the goal is to really diversify the channels through which investors could buy Avant loans and hopefully, translate to better returns for investors and cheaper rates for consumers.

Peter: Right, okay, interesting, interesting. So does that mean then....right now, are you de-emphasizing your balance sheet? What percentage of the loans now are going to market place versus balance sheet?

Al: It's about 50/50, that's the ratio we really like. We are very comfortable holding loans on our own balance sheet, but we also like the idea of allowing investors to invest in the Avant loan portfolio and Avant loan platform.

Peter: So is that the percentage you want to maintain as you grow?

Al: I think it's largely a function of how much capital we have available on our own balance sheet, but something in the 50/50, maybe 60/40 towards the market place is a good level that we think mitigates any sort of conflicts of interest from originating loans that may not be the right loans to originate, but also allowing Avant to scale without needing a huge amount of additional equity capital.

Peter: Okay, great. I want to talk about the re-branding you recently did. You went from Avant Credit to just Avant which is not a huge change, but you got a five character domain now. What was the reason for the re-branding, is there something about "credit" that you wanted to de-emphasize?

Al: No, I wouldn't say it's that, we just think Avant is a much stronger much cleaner brand that resonates better with our consumers as we looked to invest in the brand and at the end of the day, we want to be the best provider of credit and credit products to consumers. We just think that the Avant name is just a better way to do that long term.

Peter: So tell us a bit about that name, how'd you come up with it?

Al: Well, I am sure you're aware of the French meaning of avant-garde. We just like the idea that we're trying to innovate and really provide better credit solutions for consumers and do that on a global scale. So it fit really nicely with what our vision and our mission earlier.

Peter: Ah, okay. One of the things I was curious about.....you launched in January 2013, but then in your first 12 months of operation you expanded into the UK which seemed to be.....it's pretty early for a start-up to be going and moving internationally so soon. Why did you do that and is Avant....you wanted to be part of a global...you wanted to be a global brand, is that part of what you're doing?

Al: Yeah, I would say our vision is to create a global business and that's been our vision from really day one and the way we think about new markets and new products is it takes us a long time to get comfortable with the market dynamics, product market fit, credit and the earlier we can launch a product and start to gather data and information, the sooner we're going to be able to get to a point where we can scale. So that's one of the reasons we launched in the UK just nine or ten months after we launched in the US.

It' still a relatively small component of our business, but the UK operations is doing really, really well. We are looking to set up our Avant market place in the UK for loans originated there even if they.......and we're going to continue to do that. We're going to continue to invest in new markets and we're going to continue to invest in new products early with the idea being that it's all about longer term innovation.

Peter: Right, so in the UK are you focused on a similar kind of market so that this middle class borrowers....is that still the focus?

Al: Exactly.

Peter: Okay, and then obviously you got a different credit infrastructure in the UK. There's no social security number that's binding and helps create a rich credit history so I imagine when it comes to underwriting you can't use your same model that you have in the US. In the UK you have to start almost from scratch, wouldn't you say?

Al: No, that's 100% the case and I think that's true for any new market that you wade into, that you go into and that's one of the reasons we just say you have to be willing to invest in this market early to try to make sure you don't stop innovating.

Peter: Right.

Al: And whatever new market we go into, we're going to have the same challenge.

Peter: So does that mean you're going to see Avant Australia or Avant China sometime soon?

Al: I would say that Avant Australia is probably a lot sooner for us than Avant China.

Peter: Right.

Al: But we love international quite honestly.

Peter: Okay, okay, cool. So then let's just talk about some of your numbers. We are recording this in early June, what was your volume in May?

Al: We funded nearly $160 Million worth of loans in May which was a massive record for us, got us to nearly $2 Billion annual run rate and we funded just under $400 Million of loans in all of 2014 so that just peaks to the scale at which we're currently operating.

Peter: Right, okay. And what about profitability, it seems like you've got an A-list group of backers providing equity funding for operations. Is profitability on the horizon?

Al: Well, we've been cash flow positive since late 2014 in which we're very excited about. The challenge for profitability in the short term for us is that we've got accounting, we have to position for future losses for loans that we hold on our own book. We expect to turn profitable on a GAAP basis shortly.

Peter: Really?

Al: ....and be profitable all of next year so we're actually very excited about that and like I said, operationally from a cash flow perspective, we've been positive for a while now.

Peter: Right, okay, so then you are....what's your prediction for....how much is Avant going to do globally this year in loan originations?

Al: Yeah, I think we're going to do close to $2 Billion if not more in 2015 with just massive growth relative to where we were in 2014 and our view is that we launched new products and new markets and new initiative. We should be looking to scale on multiple fronts (?).

Peter: Let's talk about that for a second. What kind of new products are you looking at right now? You are doing unsecured consumer loans, is there something else on the horizon?

Al: Sure, the way we think about the market is we want to continue to meet more of the same demand from the same consumers that we're currently serving and we think those consumers really need an unsecured personal loan product, they also need a secured personal loan product so that's where we're looking to invest. They also need revolving products where they can use a card-based product to build and transact at the point-of-sale. And those are really the two key areas where we're looking to invest and add value.

Peter: Does that mean we're going to see an Avant Visa card sometime soon?

Al: I don't know how soon that's going to be, but we're definitely looking at it very actively.

Peter: Okay, and then when you say security you're talking real estate, you're talking auto, both?

Al: I mean we're really looking broadly, but I would say auto is a more attractive space for Avant in the short term than real estate. It would give us the various complexities of the businesses and our ability to roll something out to consumers quickly.

Peter: Right, but so is it fair to say that you to sort of create products for your core market, the middle class kind of consumer, that is suitable for them so you're not going to do what SoFi is doing....million dollar real estate loans is not on your horizon?

Al: Correct, at the end of the day, we are true to our mission which is really being the best provider of credit products and credit services for middle class consumers around the world.

Peter: Okay, as you look to the future, you got multiple loan products, I mean, you've got rapid growth, when's the Avant IPO?

Al: That's a million dollar question, I would say the equity markets are fairly robust and attractive, I would say over the next two or three years. An IPO is something that's pretty attractive for Avant right now. We're very focused on just making sure that we execute on the various initiatives in front of us which is very challenging. We're growing very rapidly, we're a two and a half year old company that now has 700 employees.

Peter: Wow!

Al: And we're going to continue to scale on that front so we're just trying to make sure we hire great people, great engineers focused on making the product better, more transparent, more mobile friendly, but at some point being a public company is really the goal.

Peter: Right, okay, so it sounds like...obviously, the equity markets now, sooner or later, would probably be a good move, but I guess this is not something that's in your near term horizon then.

Al: We just think of the fact that we're a pretty young company. Some of the other companies in the space out there have been around for a lot longer than Avant has been around. We have a lot of strategic initiatives that we're working on, that you and I have just talked about, international and product growth, so we just want to keep our heads down and keep executing and really building a better product for our customer segment.

Peter: Right, right, okay, well on that note I'll let you go. I really appreciate your time today, Al, it was very interesting.

Al: Thank you, Peter.

Peter: Okay, thank you.

I think what Al and his team and Avant have done over the last two and a half years has been nothing short of extraordinary. They wrote their first loan in January of 2013 and here we are now, they've crossed the billion dollars in total loans issued and they've done this with a focus on a singular market and not trying to go after the same borrowers that Lending Club and Prosper are trying to go after. They have their own niche and I think the play book that Avant have executed faultlessly, so far, is something that many other platforms I expect will imitate and that is, you start off as a balance sheet lender, you build up a track record, you build up some history and then you open up your market place and get a lot of investor interest as clearly what's happening here with Avant. It's a fascinating story and I'll be watching with great interest as they continue to grow over the next 12 to 18 months. I think they're really going to establish themselves as one of the true leaders in this industry.

On that note, I will sign off. I very much appreciate your listening, hope you enjoyed the show and will catch you next time. Bye.

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