Welcome to the Lend Academy Podcast Episode No. 47. This is your host, Peter Renton, Founder of Lend Academy.

(music)

Peter Renton: Today on the show we have a fascinating guest. He runs a company that has really made a name for itself in the invoice finance space. Jed Simon is the CEO and Founder of FastPay. Now as I said, FastPay is focused on invoice finance, but they've really targeted one specific niche and that is digital media publishing and they've been incredibly successful at focusing on that niche and you're going to learn a lot about this industry. I certainly learned a great deal. I didn't know much about it to be honest before the show, but Jed's company has really carved out a niche that is very compelling for both borrowers and investors alike. Hope you enjoy the show.

Welcome to the podcast, Jed.

Jed Simon: Thank you, Peter, appreciate you inviting me.

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

Jed: Absolutely, so I grew up in Los Angeles, I'm from here and grew up right near UCLA. Went to Brown University, undergrad, studied Philosophy and joined…as a lot of people do or did back then, worked at Morgan Stanley in the Investment Banking Media Group in the analyst program for a couple of years and from there wanted to get into the music business. So at the time DreamWorks was starting and I had been sort of a follower and an acolyte of David Geffen and knowing that he was starting a record company just seemed too cool. So, basically, figured out a way and spent a lot of time…it's a story for another time, but ended up getting a job and was an early employee at DreamWorks. I was there for almost ten years so I was in entertainment for quite a long time.

Peter: Okay, so then did you leave DreamWorks to go start FastPay? What was the transition like?

Jed: Yeah, so what happened was I worked in the Strategic Planning Group for a year or two under a guy named Ron Nelson who was the COO of DreamWorks at the time. Now he is the CEO of AVIS and did that, then I ended up getting assigned to the record company, worked for a guy named Mo Ostin, who was in charge of it, who was sort of an industry legend, one of the founders of Warner Bros. Records, actually was a founder of Warner Brothers Records, worked for Frank Sinatra, he was just awesome, but the challenge was the record business wasn't doing very well. The industry, sort of recorded music, had sort of hit its pinnacle in the mid-90's for a variety of reasons and Geffen decided to sell the company, so I was involved with that. That was actually a lot of fun, so we sold the company to Universal Interscope and I didn't want to go to Interscope so I actually switched to the film company and worked in the UK. It didn't really...I was basically in charge of international marketing and distribution for DreamWorks Films which at that time was largely almost exclusively animation at least internationally. So it was an interesting job...definitely wasn't what I wanted to be doing for a living so I spent most of my time there plotting my next step and came up with a bunch of business plans, and a bunch of ideas and one of those was FastPay, which sort of carried me through to today.

Peter: Okay, so can you tell us...what does FastPay do exactly?

Jed: Sure, so what we do is…what FastPay is, it's a liquidity and work flow platform for digital businesses globally. What we do is, we provide liquidity in capital, we also provide work flow solutions like clearing house and other types of payment solutions to become sort of the utility, the financial utility for these digital businesses.

We started with media as our first focal point because if you sort of look...if you take a step back, media was only about 2% digital in 2001 and is mostly an analog business, TV, cable, radio. Fast forward to 2015, it's about 40/45% digital and it's still underweighted. In terms of media getting bought programmatically, which means even buying television in analog format using sort of digital tools, it's going to be 100% digital within probably three or four years. So we started with media because it seemed like the need was great and the receivables were very high quality so that was our initial focal point and it proved out pretty well.

Peter: Okay, so then let's just...I think it's probably best illustrated with an example. I know you gave one in your company demo at LendIt, but I think that...can you explain to the listeners, give an example of like a media company and the challenge they have being paid and how FastPay kind of helps in this area.

Jed: Absolutely, well in the digital economy which is...even though it's probably about 10, 15 years in, it's still fairly nascent. These businesses...by these businesses we're talking about publishers, sub-content publishers, think of it as websites or applications along with advertising technology businesses, media tech businesses, demand side platforms, exchanges, these are sort of the businesses which are helping to deliver these ads for advertisers, the pipes that are sort of serving these ads to these publishers…these businesses have been particularly underserved by banks. They have fairly new business models, no hard assets.

Traditional lenders have a hard time sort of wrapping their heads around new industries. So we're vertically focused...in terms of an example, say you have a content publisher that is…say it's a male health site where you're focused...for MMA or any type of other audience that they're serving. These businesses create inventory by garnering audiences and this inventory is monetized by selling it to advertisers.

There's different ways of monetizing it. You can monetize sort of programmatically using Google and Facebook, however, sort of the Holy Grail where these guys really make most of their money is by selling to premium advertisers, selling directly to big brands or though big agencies. That's where you get the bigger dollars, the bigger ad dollars, the higher CPM to get sort of more bank for your buck. When these businesses grow and hit scale, increasingly they start selling directly to these advertisers.

The challenge is the bigger brands...you know, you talk about the M&M Mars, the AB InBevs, the Procter & Gambles, the prevailing payment terms are typically about net 120. So if you run media, give a campaign for AB InBev in January, you actually are not going to get paid until May or June and that's just standard so in the interim you still have to pay for your overhead, pay for new writers, servers, technology. In terms of marketing your site there's something called native advertising where you'll pick some of your content and try to distribute it to Facebook and other places, to try to garner even greater audiences. Those media sources typically require payment upfront or payment within, call it 15 to 30 days so there's really an inherent working capital shortfall or working capital problem that needs to be solved. So what we've created is a point solution just for that, that sort of custom fits and it works really well in this type of dynamic.

Peter: Okay, so you've got a content publisher, let's say he's getting say a million page views a month and he has like Nike or Budweiser or someone coming on board serving ads, they are then....it's obviously generating great revenue for him, but he has to wait. So he comes along to FastPay and then what do you do, how do you onboard them, how do you say, well, okay, this guy is legitimate, he has a legitimate business with legitimate advertisers, how do you kind of go through the underwriting process?

Jed: So what you're talking about here is a true invoicing economy, you've got a buyer and a seller. The seller are our clients, they're the ones who are selling their inventory or their products or their service and you have the buyers who in this case are the advertisers.

So in terms of our process flow, the way we evaluate risk and the way we think about sort of credit in our industry, there's three primary criteria, there is the company who's borrowing so that's the publisher in this instance; you have the individual who is the principal of the publisher and you have the debtor, the payer/the buyer so you've got kind of the buyer credit, the seller credit and the individual.

What we've done is, through our history and expertise in the space, we've created sort of predictive technology to speed up the underwriting and reducing risk, but it's all based upon those three sort of criteria and based upon different situations and different sizes and different sort of maturity and all the rest, You know, the algorithm sort of weighs them differently.

Peter: So then...obviously, if you've got like a Nike or a Procter & Gamble who is the ultimate buyer it means it's a very low risk transaction even if...I mean, you obviously make sure fraud is not going to happen, but as long as these guys have a legitimate business...how high...I guess the question is, how much do you weigh the buyer versus the seller?

Jed: Right and that's a good question and I think you posed the question in sort of an interesting way which you said if it's Nike, I think you said, there's really no risk, except for fraud. I would say if you look at the factoring industry, traditionally, historically, fraud has been sort of a 20x or so and that's what's been told and that's what I hear from a lot of people, sort of a 20x greater risk factor in credit. So, yeah, Nike seems to be a solid credit, you can underwrite them, probably not a lot of credit risk there, however, you've got fraud risk.

Fraud risk, number one, is this invoice real? You have to validate it which with some buyers is easy to do. They've tools where you can do that or they have APIs or in other cases you can't and you have to resort to other methodologies. You have redirection risk. One of the ways we mitigate risk is we actually collect so we have a lock box. If you to sell us your Nike invoice, the money comes to us, not to you so there is the collectibility component, so making sure the money comes to us. Thirdly is...so you're validating it, you're making sure it's collected and the third component obviously is credit risk and in this case Nike. That's probably the least of those three sort of concerns.

Peter: Right, so it's always interesting to me, you've got a lock box and you're a digital business in a digital age and you're still getting paid by check, right? Does that happen most of the time or what?

Jed: Not exclusively check, it's a combination of check, ACH and wires, I'd have to check, but it's increasingly becoming digital.

Peter: That's good to know, good to know. I think it's humorous how much checks are still actually used today.

Jed: Yeah, it's still...I read somewhere, as of a couple of years ago we were still at 70%. I think it's come down, probably closer to 50 now, but still.

Peter: Still way too high. Other countries, it's zero.

Jed: Europe is way ahead.

Peter: Same with Australia. That's a topic for another time. So let's just talk about the terms of the loans. So you've sort of approved the loan, it's legitimate, you're comfortable with it and say it's a hundred thousand dollar invoice, what are you going to advance to the seller?

Jed: Advance rates vary. Again, based upon those three factors I mentioned earlier, but you can assume somewhere between 70% and 85% is typical; the average is close to 80% or so. In terms of duration, there's two ways of thinking about it. You've got the client relationship and you have the individual transaction link. These transactions have a lot of liquidity and velocity to them, right, because you're talking about average days outstanding, let's call it 60 to 90 days across the portfolio because, yes, you've got the high quality AB InBevs and M&M Mars' and Mondelezes which are net 120 or net 140 somewhere in that range, but you also have the Googles which pay, call it net 28 or so on average so on balance, it weighs out to about 60 to 90 days. I think our average, right now, is about 68 days average DSO across the portfolio.

So you've got the client relationship which is more persistent; the client relationships last a few years. You have the individual transaction which sort of cycle on about 68-day rotation.

Peter: Okay, so then what about the interest rate that the seller pays for the privilege of getting this money quickly? What kind of APRs are they looking at?

Jed: I'm glad you characterize it as a privilege because it is a privilege.

Peter: (laughs)

Jed: In terms of the rates, we quote on a sort of face value. These are discounts to the face value of the invoice, but on an APR basis, when we started it was high, it was sort of, call it 30+%, over time it's come down. Our average is sort of in the high high teens, low twenties now, but as we've got bigger…our purview has broadened and we've kind of come more up market. We've been able to serve sort of call it greater segments of the market so we still have a lot of SMB's, but we're moving a little bit up market in terms of the ability to serve a little bit larger publisher, a larger client base. In those instances the rates can come down to sort of mid to high single digit. So it's a range, if you're smaller, higher risk, lower outstanding balances, smaller invoices...the rates are a little bit higher, call it 20's and if you're more established, a little bit more bankable, showing some profits, bigger invoice values, we're probably talking high single digits.

Peter: Okay, so does the seller typically give you all of their invoices or do you do like one by one?

Jed: Yeah, that's a good question, Peter, so we prefer and we're structured in terms of the way our process flow works, to take on all of your invoices. You don't necessarily have to finance them all, although 95% of our clients do.

The other type of strategy or product is called spot factoring. Spot factoring is not what we do, it's a different sort of business model. We're more...which kind of goes back to the beginning of the company. This is much more...we want to be a continuity product, we're looking to help you with sort of all of your capital needs not just sort of a one-time problem you may have in March because something goes wrong.

We want to provide greater financial services, more products to you so we have a clearing house we've been developing. We just launched it, we haven't really announced it yet. There's some other products in the work flow side to sort of tie us more into these clients and give them more tools and greater resources, but, philosophically, we want to become your liquidity solution and so our product is really geared toward becoming a complete solution for all of your invoices, not just become a spot solution unlike others in the market.

Peter: Right, right, that's fair enough. So let's just talk about loan volume, I know you've been around for a lot longer than most of the companies in the marketplace lending industry, so what year did you start and how much in the way of loans have you done since inception?

Jed: Going back, we started in 2010. But at the time, when I say we I should say I because really back then it was just me and unlike others, we didn't go out and raise a lot of money. I kind of came at it from a different perspective which was more of...I had a couple of…at DreamWorks I had become friends with a couple of sort of high net worth individuals, well respected people here in LA, private equity ones, kind of private equity real estate, raised a small amount of money, about half a million dollars, and wanted to sort of prove out the credit model first. I figured technology could come a little bit later. I wanted to sort of prove the concept in kind of that minimum viable product and develop a few cohorts and see...it's very easy to put money out, the hard part is getting it back, right?

Peter: Right. (laughs)

Jed: I wanted to make sure the process worked and that there was demand and that the pricing worked and all of that. So we didn't really raise a formal sort of institutional round until last year, late last year, 2014.

I think this question started with loan volume and so over time we grew organically really and so just recently have we taken sort of a formal $15 million growth venture round. Even so, we've got...to give you a sense, we're doing about $50 million a month in origination volume and a lot of that has really been organic growth, sort of bootstrapping, but now, the use of proceeds is really from this Oak investment...primarily has been our technology.

We've got a team, about 15 engineers, and we've been developing more and more of these work flow products, and iterating our platform, we're shipping another version in about a month which is really the first version that I'm in love with. The other ones have been great and our clients really like them, but this one, I think, is really going to be the first one that I feel great about. But, yeah, doing about $50 million.

Peter: Okay.

Jed: We're going to cross...we should cross the billion dollars in origination volume in the next quarter.

Peter: Wow, that is significant. So then, okay, so you're almost at a billion dollars, what about bad debts, how have you been going with how that’s concerned?

Jed: Bad debt has been about under 10 basis points, historically, and that's been pretty consistent.

Peter: Wow, so.....

Jed: Yeah, 10 basis points, I think is on the very low end of the spectrum for sort of our peers in the industry. I think that speaks to a couple of things. I mean, I do think that are sort of our underwriting team has done a great job and they've developed sort of the right algorithm. I think we kind of figured out how the risk curve rolls out in this industry that we're in.

I also think this vertical sector that we focused on initially...you know the whole premise was you've got a very strong set of buyers and a fairly dislocated set of sellers and I think that premise has played out...you know, there has not been a lot of credit defaults, but, obviously, we've figured out the validation and redirection component, and lastly, I'd say this asset class just due to its sort of velocity...you know it’s an asset class you can monitor very closely, it's got a lot of velocity to it, it's got a lot of liquidity to it so, I mean, those sort of three things together is why we've managed to sort of perform at that level.

Peter: Okay, so let's talk about borrowers, I mean, you mentioned this thing, they’re a dislocated bunch, the sellers you've got, everyone from like this guy and his garage with a website, who has got some traction through to real publishers, magazines, all sorts of different publishers who are very well established.

Jed: A fair amount of pretty decent-sized technology companies doing hundreds of millions in revenue.

Peter: Right, right, so how do you find these people, how do you find borrowers who are interested in getting your financing options?

Jed: So in terms of sales...look, the hard part of credit businesses, in my opinion, and having been in fintech for a bit, you meet with a lot of people with a lot of ideas, you see the business models, but I would say, origination is typically the hard part, more so than capital, in my opinion. In terms of how we originate, in terms of targeting buyers or sellers, we developed sort of a sales strategy over time, but most of our clients come through referrals, about half, so we started off with sort of a small set of clients then they told their friends and they told their friends, and then we've gotten a little press and all of that and that's driven a lot of our growth.

We have an outbound sales team, but we've been increasingly working through the buyer universe. In other words, you can target these sellers one at a time and it works and then they tell each other and you sort of develop that, but, increasingly, we've been working through the buyers because the buyers...you work with the seller...you sign up a seller, you get one seller.

Peter: Yeah, it's one at a time.

Jed: You sign up a buyer who has a thousand or ten thousand or a hundred thousand sellers and you can develop some sort of partnership whether it's a supply chain solution or a marketing partnership or a referral partnership then you can target.

So we've been doing...we announced a partnership with Mediaocean which is a software company. I tend to think of them as sort of the Bloomberg terminal for advertising agencies. I think they have something like 50,000 or 60,000 terminals out there. Most of the large agencies in the US, I think pretty much every one of them like the WPs, the Publicis, Omnicom and IPGs, sort of the big names, all use their software to do their procurement so it's the work orders and the statements of work and the IOs and invoicing all happens through this sort of financial work flow system called Mediaocean. So they're our exclusive partner and through them we're now in discussions and you'll see some announcements with various clients of theirs to develop solutions to offer our product to their vendor bases.

Peter: Okay, okay, that sounds...

Jed: So to answer your question, we've been historically targeting sellers and we're going to keep doing that, but now we're increasingly working through the buyer channel to scale.

Peter: Yeah, right, fair enough. Okay, I want to switch gears to the investor side of the equation. You said in the panel at LendIt that you believe the hybrid model...you have a balance sheet, you have a marketplace. That's a very strong way to run your business so I guess, firstly, why do you think it's a strong way to run your business and then who are investing with you guys today?

Jed: Sure, what we're trying to do is develop some sort of a diversified strategy on the funding side. I don't think we want to be beholden to any particular strategy, overly beholden, so if you're working only with commercial banks, you have your own regular balance sheet, if there's some sort of downturn and that market dries up, you're sort of not in a great position.

Peter: Right.

Jed: If you're a hundred percent marketplace and for whatever reason the tides turn and those guys either…let's say you're working with a lot of credit opportunity funds and all of a sudden there's a downturn and they can get higher yields elsewhere that could dry up so for us having the diversified strategy just seems to make sense if you have different types of capital from different asset classes then presumably it makes you more resilient. We'll see how this all plays out so we've got an on balance sheet and marketplace.

On balance sheet we partner with Wells Fargo, there are some other banks coming into our syndicate soon. SF Capital, who is one of our equity investors and our partners who have been unbelievable partners all throughout. On the marketplace side, we work with a variety, probably about a dozen marketplace investors, and there's different sort of forward funding agreements there, but, yeah, we have a pretty good mix now between the two and we may even add a third sort of strategy next year, something we're discussing internally.

Peter: Okay, so then are you open to new investors today?

Jed: We are. Particularly, as the world...for investors who are concerned about sort of where this is all heading or where we are in the cycle, I think having an asset class that's got a lot of liquidity to it, where you're not making a 3-year....you're not locking yourself into a 5-year investment, you're talking about sort of shorter duration loans, very high credit quality, I think that's attractive in terms of the overall mix. We've been seeing a lot of traffic from people who are interested and we're definitely open to extending the marketplace as we grow.

Peter: Sure, so can you share anything along...you've got such a low loss rate and your APRs are reasonably high. I imagine you're returning solidly in the double digits as a net return to investors, can you give some idea of expectations there.

Jed: I think the expectation...look, we do have investors who are getting double digit returns and it's been working well. The area where we've seen a lot of growth and a lot of demand has been in the higher credit quality area so think of them as bigger borrowers, higher credit quality, lower yield, so I would call it mid to high single digits, but you're talking about sort of a lot of triple A credits in terms of debtor quality in there. So that's been an area of growth and that's where we're focusing. There's a fair amount of interest in double digits, double digit yields in the marketplace, but we're really looking for sort of single digit guys looking for higher liquidity, higher credit quality because that's where we stand in terms of the overall risk curve.

Peter: Okay, yeah, sure, so before I let you go I've got a couple of more things I want to cover.

Jed: Sure.

Peter: You recently expanded to the UK so can you...are you just duplicating what you've done in the US? Can you just tell the listeners what you're doing in the UK?

Jed: Sure, well we've seen in the UK market and some of the other Euro markets some real structural similarities on both the buyer and the seller side in terms of dynamics. You've got a lot of the same ad agencies, in fact, almost identical, so the debtors are largely the same. I mean, the global advertisers are pretty much...if you look at sort of the mix. You do have a few in the UK there is Reckitt Benckiser which is kind of like their Johnson & Johnson. We've seen a lot of activity from them, but the reality is it's a lot of the same debtor credits, a lot of the same agencies and on the seller side, very similar market in terms of types of sellers and concentrations and business models and all the rest.

So our platform is highly extensible...what we've built and so what we did last year is we got all the licenses and the capital lined up to go into that market. We started testing that market, we have some early success stories there so what we're really looking to do is sort of expand more of a sales and operations office than sort of much more than that, but we started training there, it's going well, just hired a few people so by the end of the year we'll have that office staffed, but there should be other markets as well added to the mix, next year, additionally.

Peter: Okay, so, yeah, that's my last question. Are you looking to be really...like you talk about digital businesses, but then you said the vertical you're focused on is media, digital media businesses. Are you really going...is your plan to be a digital media business and expand that into like other geographies or are you going to expand across different verticals? What's in your crystal ball for your planning?

Jed: Well, we obviously spend a lot of time in the market, we look at a lot of opportunities and as we've scaled a bit we've gotten more inbound opportunities so we have to sort of evaluate and put them through sort of our competency check list and see where it makes sense. What we know is that the core market we've been focusing on initially, which is really media and advertising, digital media and advertising global, it's growing really quickly. It's been growing about 22% per annum since we started this and it's truly international.

You're seeing a lot of these guys, a lot of really interesting tech companies that are selling to…these same global advertisers are based all over the world and for us it makes a lot of sense to sort of capture this market, we understand it really well. In credit it takes a long time to sort of understand market and credit dynamics and prevailing terms and conditions and payment patterns and all of that which I think we've done a really good job focusing on this vertical...one of the reasons why our loss rate is so low. So it makes a lot of sense to extend that into other markets.

In terms of horizontal, other verticals, there are some sort of very close tangents that we've been selling products into and testing. There are some other sort of digital verticals that could make sense down stream, but for now we found a sweet spot. There's an awful lot of headroom we want to exploit that really, you know, maximize it and keep building products to serve these clients.

Peter: Right, right. Okay, well on that note I'll let you go. I really appreciate you coming on the show, Jed.

Jed: Thank you for inviting us, it was a lot of fun. Thanks, Peter.

Peter: Okay, see you.

Jed: Bye,

Peter: You know there's certainly options for new marketplace lenders entering the space today, but I think targeting on a specific niche certainly gives an advantage to the platform because they're able to understand it and develop tools and marketing approaches specific to that niche. Particularly with invoice finance, I think different niches have very different needs and what Jed has been able to do with FastPay, particularly given their extraordinarily low default rates, I think what he has been able to do and build up to a really decent sized business in a relatively short period of time I think demonstrates the power of that approach where you basically learn all there is to know about one niche and provide a service just for that. Now it's not going to work for everybody, but it's certainly working well for FastPay and I wish them all the best.

On that note, I'll sign off. I very much appreciate you listening and I will catch you next time. Bye.

(closing music)