LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 82: WILL DAVIS

Welcome to the Lend Academy Podcast, Episode No. 82. This is your host, Peter Renton, Founder of Lend Academy.

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Peter Renton: Today on the show, I am delighted to welcome Will Davis. He is the CEO and Co-Founder of Able Lending. Now Able Lending is an online small business lender, they've been around for a couple of years, but they have a very unique twist on the small business lending concept. They introduced the idea of backers so a borrower obtaining a loan can get a lower rate when they have other people actually contributing into the loan. So it's something that is unique, it's working well for them so far, and I wanted to get Will on the show to talk about this. We actually go in depth into the concept that he's trying to do here and we also talk about what that means as far as cost of capital, as far as delinquencies and that kind of thing. We also talk about how he's doing as far as their scale, who the investors that are actually coming on to the platform and much more. I hope you enjoy the show!

Welcome to the podcast, Will.

Will Davis: Thanks for having me, Peter.

Peter: Okay, so let's get started by giving everybody a bit of background about yourself and what you've done over your career, particularly before you started Able Lending.

Will: Yeah, well originally from West Texas and really felt a calling for public service right out of college and I ended up actually working on Capitol Hill as basically the designee of a representative from my district on the House Financial Services Committee so that was an incredible experience. It was from 2005 to 2008 and when we first got there we were talking about how to get people into homes with no money down, etc. and when I left we were experiencing a major meltdown in the housing market so it was certainly eye opening to see 'how the sausage was made' and really turned me on to fixing problems in society from the outside in.

What I mean by that is that I went to Washington, sort of classic Mr. Smith goes to Washington, bright-eyed, bushy tailed, thought I was going to change the world and I found that Congress and government as a whole was fairly reactionary to events outside of Washington and the way to actually to make a difference in society was to go do something outside of the beltway. So that desire led me to go to business school which I went to Harvard Business School, surprisingly I got in, and after business school started a fairly crazy startup that was designed to disrupt the postal service.

And you say, well how did you get from postal service startup to Able Lending. It's been a long windy path, but I think the roots of that are within my experience in the Financial Services Committee on the House side of things because that was the first time that I had ever heard of peer to peer lending, for instance. There was a Congressional Research Office Report on peer to peer lending and I remember reading that in 2006 and thinking, wow, this is a really disruptive way of thinking through things, never thought in a million years that I would end up doing a peer to peer type startup just six years later.

Peter: Right, right, that's fascinating and I actually remember your Outbox company that I actually looked into using myself at the time when I had left to go back to Australia for an extended time.

Will: Yeah, you were one of the two people that looked into it.

Peter: (laughs) Right, okay so then you decide to move on from disrupting the post office to disrupting small business finance. So could you just tell us a little bit about the founding story of Able Lending and how you kind of came up with the idea in the early days?

Will: Yeah, early days…go back about two years and we were looking at the small business lending market, but really fintech in general and so it was a little bit broader than that. We were looking at like Uber and Lyft and Airbnb and these very disruptive business models that had sort of upended their specific industry and at the time Lending Club was doing really well. I still consider them a leader in this marketplace, but at the same time Airbnb, for instance, is having more hotel stays per night than Marriott, right? So there was this kind of nagging question in my mind of thinking, well, if someone had disrupted the lending business like Airbnb disrupted the hotel business, then Lending Club should be bigger than JP Morgan and why is it not?

What we really focused on was the nature of what was being shared. So when you think about what is being shared with Lyft or with Airbnb, they're sharing the highest cost component of their better service and with Lending Club, they're sharing their capital, but oddly, when you share capital amongst peers and that's the only thing that you share, the actual cost of that capital is higher than you get from institutional investors like large pension funds and endowments, etc. who have billions to go work with and are looking for 4.5%, 5% return while you know, the long tail of retail investors are searching for 8% or 9% return and then that plays out in other peer to peer startups where they actually get the majority of their money not from peers but from institutions.

So we kind of noodled around with that and thought well, what if sort of the wrong thing is being shared and that's where we landed on the concept of sharing risk. Ironically, the only way that you can share risk in finance is to share some type of capital, but our capital is geared to getting actually the least amount of peer backer support into each loan and the main thing that we're solving there is the calculation of the risk because whenever you think about the cost of a loan at scale, the cost of capital is all the same and what you're differentiated by is how you price risk.

So that's what we're sharing in the Able concept is we're actually sharing the risk with backers and so friends and family come into each one of our loans and they take a subordinated position allowing our senior lender to essentially get paid back on a quicker amortization schedule. In turn, that senior lender, because the risk is being shared, can offer a lower cost of capital and also experience a lower loss given default at any point of default and that's before you even start to imagine the sort of social peer pressure effect of having backers into a loan.

Peter: Right.

Will: And so because of that, we're able to source lower cost of capital and therefore drive the cost down to our end user. Without getting into the details of each specific cost of capital that we have with each specific deal, we do know that on average as we compare our rates with other lenders, we generally save somebody about $30,000 over the course of their loan in interest payments alone because we're able to offer that lower rate.

Peter: Okay, I want to dig into that a little bit because it's a unique approach, it is not what many other companies or any other companies really are doing in the small business space at least. Let's start with an example...or maybe you can just give us a real world example of someone who comes along and they apply for a loan and you give them a rate. So what is that rate, what is a typical loan amount and then what is the process for them to go out and try and reduce their rate. Can you just talk us through an example?

Will: So let's just go through a typical example of a $100,000 loan that somebody is applying for. We'll upload their bank statements, we'll upload their QuickBooks automatically; it's a very simple process. We run it through not only our risk model, but we actually put human expert underwriters on each application and let's say that they're approved for a loan.

Well this particular business would get a range of options. We actually have a very dynamic way of introducing a loan to somebody and so let's say they had a fairly good debt service coverage ratio, just above one, just call it, okay. Typically, they'll get an offer from us that requires no backers and so that rate may be a 17% rate with no backers. What they can do is they can dial up the backer percent and they can say what if I raise 10% of this loan so $10,000 and Able brings in $90,000. All of a sudden your rate goes from 17% to 14.5% just automatically and they see the cost savings side by side.

Now they don't have to take that, but if they want to take that they can and usually cost sensitive entrepreneurs are looking for the lowest and cheapest cost of capital. What that backer percent also does is that also opens the aperture so to speak, of the loan, meaning that we can offer that loan at a longer term. As you know, a longer term is actually more meaningful sometimes for the cash flow, the near term cash flow of a company and so whereas the $100,000 no-backer loan would be at a 30 month term, the 10% backer loan at 14.5% could be a 36 month loan. So you can see that that becomes very, very powerful and so when we make an offer to somebody, we're able to sit down with them over the phone so to speak, and kind of play around with these different variables and have them choose what they want.

They can dial up that backer percent as high as they want to and they could go all the way up to 50%, 60% backer support because it will only just drive down the cost of their capital and make it more affordable for them. Now that's a fairly good company. Let's say a company came in and they were outside of the credit box of all the name brand lenders...well they're probably outside of our credit box too, but we're able to offer them a loan, say at 30% backer support, and say, hey, listen, we can't give you a loan at no backers, but we can offer 70% money to you if you can go raise the other 30%. We can still offer you this loan at 17%, 18% APR which is still affordable, you're going to have to do a lot more work to get this loan, but the loan that you do get from us is going to be by far the cheapest loan.

We really use that backer percent, that backer support lever to keep our loans within an affordable bandwidth because quite frankly, we don't think it is sustainable for companies to pay 40%, 50%, 60% APR on money over and over and over again, especially with some of these high interest rate lenders whose business models are predicated on multiple loans being taken out in sequence back-to-back as companies are actually relying on that capital because they get into that trap. So that's how we're able to structure our loans.

Peter: Right, okay, so just following up from that, so someone gets let's say 10% backer support, they've got $10,000…do you, I guess a couple of questions. One, are you underwriting the backer, I mean, how do you determine that they haven't just taken out a $10,000 cash advance on their credit card and say here is my backer.

Will: Great question. Yeah, so the only thing that we do is we confirm the identity and the validity of that person. That person is sent a link, they come on and they follow a link to be invited into that loan and then we ask them for some very basic personal information and then we run through the public databases checks on them to make sure they're legitimate individuals. So long as they're legitimate individuals and they are who they say they are in terms of their relation to the person, etc., then that's the extent of the background checks that we do because we feel that whenever a backer comes in there has to be at least two outside backers to the company.

So when you have not just one person giving a loan, but a second and third person who's actually backing that loan, it actually becomes exponentially harder to collude with multiple real people to commit loan fraud. I say all the time it's easier to commit loan fraud against just a normal lender than it is against Able because you don't just have to come up with one false identity, you have to come up with three false identities to even get through the door with us and that's even before we do other checks on business bank accounts, etc. So it's actually very, very hard...it would be very hard to collude. We've seen one instance where that's been attempted, but we sense it out really, really quick.

Peter: Okay, and then so this person has said that I've got backing for $10,000, are you helping them with paperwork with that or are you just taking their word for it?

Will: So what happens is those backers come in and they go through the background check which is all automated and then they submit their banking information. We actually pull it from their banking account via ACH and we essentially pull the backer funds at the same time, they clear our account and then our senior lender comes in, we combine that money and push it out into the borrower's hands.

And then the repayment is such that we, as servicer control all the flows of those monies as they're coming back to us in monthly payments and then what we do is we divvy out what's owed to the senior and then to the backers as well. So the backers, while they're not receiving principal each month, they're receiving interest payments each month. So if the backer is charging 10% on their money, they're receiving interest payments on that 10% each month.

Once our senior is paid back then the backer is going to receive an accelerated principal plus interest payment for the latter part of the loan, sometimes that's the last three months, sometimes it's the last six, sometimes it's the last 18 months of the loan. Whatever that is, once the senior is paid back and is out of the loan then the backers receive their full amortized payment.

Peter: Okay, interesting, interesting. So I can see how that..the backers are really putting their money where their mouth is.

Will: They are, absolutely.

Peter: …they actually have to take the money out of their account. Okay, that's fascinating. So then who are the borrowers that are coming to you? Are they a different kind of mix do you think than who would be going to say a Funding Circle or StreetShares or those sorts of people, who is coming to you guys?

Will: I think honestly, the borrowers are fairly similar of StreetShares, Funding Circle, Bond Street, etc. I think those are all sort of in the range of the type of borrower that come to us. Oftentimes they're shopping around, they're looking at us, looking at some other people, but we're talking about a company that has maybe been around for three years. They may have say a million dollars in revenue, still cannot quite break into that bank loan, that SBA loan yet nor do they have the time to do that and so they're actually looking for either equity or debt capital.

Usually at this time, it's beginning to make more sense to have debt capital than equity capital especially for the types of businesses that we're working with where there's not necessarily going to be a liquidity event in the future, but there are nice cash flows that can be seen being spun off in this company and they're growing and so we oftentimes...you know, are underwriting for purchase orders and underwriting the whole business taking into account not only their growth to date, but also their future growth and what they can prove to us.

So what's nice about the Able loan is that through the backer model we can offer very, very cheap cost of capital not just to meet a purchase order, but also to allow for hiring before the fact, allow for some marketing that needs to be done and allow for maybe a build out or something of a shop where they can't get bank financing. So those are sort of the type...the phenotype of the company is somebody that's growing rapidly, but still has not been able to break into the banks, so to speak.

Peter: Got it, so how are you finding these borrowers? What's your marketing strategy?

Will: Yeah, well that's I think the million dollar question for every alternative lender.

Peter: (laughs) Literally it is.

Will: Yeah, exactly, and so we decided early on we wanted to do best practices in everything. We want to be best practice in our risk-based pricing model, best practice in our legal structure, best practice in our servicing, in our product, every single thing and that filters down into cost of acquisition. So when you look at our acquisition spend, we're spending money on direct mail, we're spending money on digital demand, we're spending money on creating our own list from databases on telemarketing and e-mail marketing, but I think what's fascinating about the Able model is it really does come back to the backers and you say well, how is that possible?

Well in each loan that we do, we have a one-to-many relationship and so every other alternative lender in the world has a one-to-one relationship right now where they have a relationship with their borrower and no one else is associated with that loan on a sort of personal basis. With us, we're averaging a one-to-four relationship and so we have this one-to-many relationship where we're not just interacting with the borrower, but we're also interacting with their backers. And every single month that backer gets a payment notification and they see that their return is on average actually a lot higher than many other investment opportunities that they have.

So while there are a lot of family members that are involved here, etc. that are not necessarily investing in second and third businesses, there is a very large percent of our backers that are active investors in other businesses in their community. So that one-to-many relationship is something that...while we're doing best practices on all other aspects, we're very, very focused on building what we call the "Able Network" and that network is comprised of borrowers and backers who are actively building, but also seeking great entrepreneurs to invest in.

And so we've seen backers that have become second and third time backers that actually bring loans in; we've actually seen backers that have their own companies that have become borrowers and borrowers that have become backers. So we see a nice sort of cross pollination of these two types of people and I think as we continue to grow our loan book and grow that network, we're going to start to see a flywheel effect as we just get larger and it's just going to take time.

Peter: Right, right. So what percentage of your loan book to date have backers...at least one or at least two backers, I guess that's the minimum, so what percentage of that?

Will: About 85%.

Peter: Oh wow, so it really is...most people are doing the backer thing. Fascinating, fascinating. What about...like you've been in business I think for a couple of years now or maybe a bit more than that, can you give us some idea of the scale of your business today?

Will: Yeah, yeah, so we're lending in 42 states, we're seeking our lending license very soon in California, so that's the only major state that we're not in so we're a nationwide lender. In the first year and this is kind of interesting, you go back, you look at the beginning stages of alternative lenders, especially the ones that have a very unique business model like even Lending Club way back in the day. They did you know, in the single digit millions in their first year, in the $20 to $30 million range in their second year and $70 to $100 million in their third year. We're actually tracking very well so we did something like a little over $3 million during our first 12 months, about $30 million in our second 12 months and we should do somewhere around $100 million in our third 12 months or our third year of operations.

I think that actually tracks really well with very novel concepts, especially new concepts like the Able model and so, I think that's just interesting from a historical perspective, but it's also interesting to say, are we building a sustainable business here? And we're very, very close to profitability and we've been laser focused on that over the last six months of basically being able to control our own destiny once we've hit that scale of profitability. And then there's certain intrinsic attributes of this model that make us better so for instance, if we can get to a volume where we're profitable then we have two things that separate us in the marketplace.

As we continue to grow our cost of capital is going to continue to come down, however, while we'll be at parity with perhaps the cost of capital, we'll always be able to charge less and therefore have a pricing advantage in the market. The second thing is we'll always, because we have the one-to-many relationship, we will always have a cost advantage on the acquisition front. So here you're building a business where you have a pricing advantage and a cost advantage that's inherent into what the model is itself. I think that's very, very powerful if you can pull it off. I always say to people we are six months away from great success or great failure.

Peter: (laughs)

Will: …and we've been that way for two years now and so I think it's about keep fighting, keep building, keep growing, do everything you can until you hit that event horizon to sort of get out of the atmosphere of a startup land.

Peter: Right, so just on that profitability I've got a couple of questions. Before I do that, how are you seeing default rates trend or delinquencies? I mean, you've got 85% of your loan book with backers, is there a big difference between that 85 and a 15 or can you give us some stats?

Will: Yeah, so I'll just speak to across our loan book right now. Without going to details, we have three companies, for instance, that have gone under and have paid us back in full. The reason they paid us back is because they said, we do not want to default on our friends and family and so even though that's not empirically enough evidence to prove that the model is working, it's a very strong anecdotal evidence. We obviously have people that have been slightly delinquent on our loans, but only three borrowers have ever been over 30 days delinquent and all of those have been worked out.

Again, it's that backer concept and so what's fascinating about this is that even though we're young and even though we're small and we haven't had a credit cycle, etc., etc. we are seeing from the frontlines of this really powerful evidence that this works and so as we continue to scale and as our loan book matures and it's seasoning, we're going to be able to attract and demand a lower cost of capital that will only amplify our competitiveness in the marketplace in terms of how we price our loans.

Peter: Right, right, let's talk about that cost of capital for a second and the other side of the equation. You know, I was actually having lunch with Jacob Haar a couple of weeks ago and your name came up and I know you guys just signed I think it was a $100 million deal with them. Can you just talk a little bit about that deal and how that came to fruition?

Will: Yeah, well, I won't get into specific deal terms like cost of capital. What I will say is that if you're an alternative lender in this marketplace, there's no better partner than Jacob and his team at CIM. They one, I think, are the most experienced investors in this space and as a result of that they make you better. So we've been talking to Jacob and his team off and on just touching base and catching up for over a year and just communicating our progress, how we're doing, etc. and then it really got interesting in May of this year where we started seeing some major growth in our originations at the beginning of the year and then in May, June and July that just continued to happen.

That's where we got into some real discussions with Jacob and his team and I tell you, raising equity money is one thing, raising debt money is a whole other animal. So they came down to Austin and spent several days with us. You know, I think we spent well over a month just in due diligence, but then they were actually very, very quick to close, meaning they're efficient; once they make a decision, they can close really, really quickly.

That was just a huge inflection point for Able because as you know, at the very beginning you have to use your equity capital to start lending and then if you've proven yourself a little bit you're sometimes, hopefully, able to hit the next hurdle which is getting small outside investors to come and purchase those loans off the balance sheet and to prove out the model again.

The other inflection point is getting a larger facility that allows you just running room. I think the fact that we hit that hurdle was very important for us and our investors to know that we have something that's a sustainable business model here because we have access to raw material.

Peter: Right, are you currently looking for new investors, how does it work? Are you actually running a marketplace or are you taking this money on to your balance sheet and lending it off? What's the mechanism on the investor side?

Will: Yeah, so we are an off-balance sheet lender and CIM is purchasing loans off of our balance sheet, but we are actively in discussion with two other alternative lending capital providers right now. Now is that called a marketplace? I tend to shy away from calling that yet a marketplace, it's more of people that are interested in your product, they're coming into your store and purchasing it off the shelf so I think that it's not quite there yet.

Obviously, as we get to scale the goal is to have multiple buyers of loans and then the ultimate goal is to hit the securitization market and really all of these things are intended simply to drive down your cost of capital. So we're seeing a lot of interest in our product though because of the CIM deal, but also as people continue to look at the model and look at the data that we're able to provide for them. So I think at our volume, three, four buyers of loans is probably...you're sort of maxing out what you're able to offer each of them in terms of deal flow.

Peter: Right.

Will: But as we continue to scale the next logical inflection point, when you're getting to the hundreds of millions or even billions of dollars per year, then you're talking about warehouse lines, then you're talking about securitization, I think that will all come in time.

Peter: Right, right. Okay, we're almost out of time, but I've got a couple more questions here. So your co-founder, Evan Baehr is someone I've communicated with over the years and he recently departed the firm which was a surprise to me and I'm sure to many people, can you just tell us what happened there, what's your relationship like with Evan?

Will: Yeah, well Able was actually the second company that we built. Prior to that we did Outbox as we discussed earlier in the interview, so we have built companies together for the last five years. I think that as we both looked up at the next inflection of Able we were thinking...well, one, were our individual skills lining up with the business and two, our individual passions. I think, you know, Evan is...I call him a generational talent in terms of his ability to network and be connected to the outer world. I think he was looking to do something else and it actually came at a time where it was both really good for him to do that, but also could open up some ability for Able to invest in other people to come in and fill some roles.

So from that perspective, it was actually like a very humble decision by Evan to say...hey listen, not only am I not as passionate as I should be about this, but I actually think that I would be better doing something else and that someone else would be better doing what I'm doing right now. Anytime you can come to that decision in a startup that's actually a very humble thing to do and it's actually really powerful for our team to hear something like that and so Evan is still on the board and he's going to continue to remain on the board.

I still talk to Evan all the time and he's still a very, very integral part of the business, but I think that too few people do what Evan did which is to say...hey, you know, I'm not just going to hang on just to hang on here if it's actually better for me and Able for me to do something else…then that's just a logical next step for us to do so I really applaud him for doing that. I also think, you know, I give credit to our board and the rest of the team for both hearing that, but also giving us time to sort of think through how should we do this.

I think we made the announcement in October, but we had been talking about this for a number of months before that and just having that time and that thoughtful approach, that deliberate approach to making a decision was really, really important. I wish that more startups would do that and more founders quite frankly had the guts to do what Evan did.

Peter: Sure, that makes sense. So what's next for you guys, I mean, you're looking to 2017, still trying to scale up, what are your plans for next year?

Will: Yeah, obviously continuing to originate some great loans in the portfolio. I also think that the backer concept is sort of a platform in and of itself and so right now we're applying for instance terms loans, to that concept. You'll see us apply different types of products still using the backer concept but in different ways and have loans that have different attributes to it that'll make it even more attractive capital for individuals. So, obviously that takes flexibility on behalf of the lending capital, but also really creative outlets for our team. I think you'll see that in the next year and we'll obviously be on the march to California which will be a really important move for us as well in terms of opening up our lending products into the market of California and hopefully, a fairly large next round of equity capital that gives us more fuel for the fire.

Peter: Alright, well on that note, it's been fascinating chatting with you, Will, I really appreciate you coming on the show.

Will: Thank you, Peter.

Peter: Okay, see you.

Will: Bye.

Peter: I love the idea of the backed loan concept. That it's something that you can actually have friends and family come into the loan. It feels like a win for the borrower because they get lower rate, it's a win for Able because they have more like social insurance, shall we say, on the loan. He talked about those people who paid back the loan even though they went out of business. I imagine that would be very unlikely if in fact they didn't have the backers in that loan.

So it's a question of can they scale this? It sounds like they've got a lot of the pieces in place and I'm hopeful that something like this...because it really gets to me, it feels like sort of the roots of the industry, the sort of peer to peer kind of roots that we began in. It still appeals to me to this day. I feel like that's kind of where Able is playing a little bit and it's something that I certainly wish them all the best in going forward and it will be fascinating to see whether they can actually get this to a large scale.

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

(closing music)