LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 252-SEAN SALAS

Welcome to the Lend Academy Podcast, Episode No. 252, this is your host, Peter Renton, Founder of Lend Academy and Co-Founder of LendIt Fintech.

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Today's episode is sponsored by LendIt Fintech Digital, the new online community for financial services innovators. Today's challenges are extraordinary with the upheaval affecting all areas of finance. More than ever before, we need to come together as an industry to learn from each other and make sense of this new world. Join LendIt Fintech Digital to connect and learn all year long from your peers and from the fintech experts. Sign up today at digital.lendit.com

Peter Renton: Today on the show, I'm delighted to welcome Sean Salas, he is the CEO and Co-Founder of Camino Financial. Now, Camino Financial is a really interesting company, they are small business lender focused on the Latinx community and as you'll hear in this interview, this is more than just a business to Sean and brother, his twin brother and Co-Founder, Kenny.

This is their life's work and you can hear the passion in his voice where he wants to do everything he can to help Latinx small business owners and we go into some detail about how he's doing that. We talk about the impact of the current economic crisis, we talk about how they're funding these loans and the typical terms that the loans have and the typical small business owner that comes to Camino for a loan. It was a fascinating interview, I hope you enjoy the show.

Welcome to the podcast, Sean!

Sean Salas: Thank you for having me, Peter.

Peter: My pleasure. So, I like to get these things started with a new guest by giving the listeners a little bit of background. So, maybe you can tell us what you did before you started Camino.

Sean: Yeah. Before I started Camino Financial, my twin brother and I.....I can never introduce myself without introducing my twin, we've been partners in life on the day we were born and right before starting Camino Financial, we were both getting our MBAs at Harvard Business School. We used that opportunity to incubate what is Camino Financial and before that, we were pretty much cutting our teeth on Wall Street in investment banking and private equity.

Both of us worked for two of the largest minority-managed funds where they focused on investing in minority entrepreneurs, or communities with a high concentration of minorities. So, that's really where we got our backbone, so to speak, in business and really helped us propel what Camino Financial is today.

Peter: Okay. So then, it sounds like you incubated...you had the idea while you were at Harvard, maybe tell us, where did the idea come from originally for the company?

Sean: Yeah. No, our story really stems back from our upbringing. Both of us are sons of an entrepreneur from Mexico that came to the United States in pursuit of the American Dream and I know that sounds very cheesy, but quite frankly, that's the story of many immigrants that come to the United States. And so, like an immigrant with very big dreams, my Mom came to the US and she saw entrepreneurship as the only avenue, given her limited educational background, to generate real wealth for herself, her family and her community. She opened over 30 restaurants here in Southern California.

Peter: Wow!

Sean: Yeah, while pretty much raising six children so, super Mom all at once, and so we grew up in that environment. Unfortunately, my mom did lose her business, it was like a house of cards that came crashing down after 25 years of very hard work. Kenny and I were 12 years old at that point in time and my Mom was devastated. So she decided, guess what. I'm going to remarry, move back to Mexico with my two youngest sons and restart my life and that's actually what happened. You know, for a 12-year old kid moving back to Mexico, that was pretty traumatic in its moment, but quite frankly was a blessing in disguise. We grew up in Mexico from 12 to 20 years old, something that I think does reflect, in the cultural and nuance of how Camino Financial does work today with our members.

We came back to the US and re-pursued that American Dream, once again the cheesiness, but we got to re-live that immigrant story, coming back to the United States while we were citizens and we are citizens, you know, in a way feeling what it means to come to a country in pursuit of something bigger than what you can achieve in any other place in the world. And so, that, effectively, laid the ground work for what we ended up doing, you know, going to UC Berkeley than Wall Street, as I mentioned, and then incubating Camino Financial at Harvard Business School.

Peter: So, is it fair to say then that the idea really germinated well before you even came back to the US?

Sean: Yes. I mean, it's so funny, my Mom wanted us to be Mexican Mexicans and I considered myself a Mexican American. She really wanted to keep us in Mexico, but when you're a 12-year old kid and you see your Mom lose her business, there is anger that is born deep within you and I'll never forget the day that we pulled out of our home in Hidden Hills. We were born in a way with that silver spoon and it was taken away from us and the entrepreneur in me was born that day, there's no question.

So, it was born many years before Camino Financial became a thing and we called it Camino. It wasn't a light bulb moment where I was in a cold shower and oh, all of a sudden, I need to help, Latino businesses but it's ingrained in my DNA, so to speak. Now, that said, I do think there were very....working on Wall Street, specifically in private equity and working for a fund that had an orientation towards investing in minority entrepreneurs which is always, as I mentioned, a theme in my life.

I felt that private equity as an investment vehicle is (inaudible) to invest in Latino-owned businesses, in particular, probable because while this market is big, the average size of a Latino-owned business, measured by our research, is about right in the range of $200,000 in revenue per year. That's one third of the size of non Latino-owned businesses and in private equity we wouldn't invest in businesses that generated less than $7 Million in EBITDA, or profit cash flow. And so, private equity, of course, was catering to those very few businesses that are very large and made it, but the great majority, call it 97% plus of all Latino-owned businesses generate less that $1 Million in revenue and skewed towards that $200,000 range.

Peter: Okay. So then, El Camino means the way, right, is that the translation?

Sean: El Camino means the way and so we called.....so, what we're doing at Camino Financial is simple. We're a fintech platform pioneering affordable credit to under-banked Latinx businesses which we quantify to be a $50 Billion untapped credit in this market. Now, the reason why we use the word Camino deliberately is because we get it, not all businesses are going to get the optimal interest rate they want, right.

They're going to be charged in the high 20's, low 30's with our core product and so, what we want to do is help them build a path to more money over a longer term and at a lower cost. And so, in order to create that path, we need to pair capital with an educational experience that enables them to formalize their business, develop a credit history and, quite frankly, get the paperwork in order so that they can then qualify for a lower interest rate loan.

Peter: Right. So, let's maybe dig into that for a little bit. So, tell us about the loan product, what's the range of interest rates, what's the typical loan size, loan term, that sort of thing.

Sean: So, our core product is a micro loan, it's a loan between $5,000 to 75,000. The annual interest rates are between 25.5 to 40% and the term, we start at 24 months which is very unusual for our industry, as you know, and we go up to 36 months, there is no pre-payment penalty so, we've been able to benchmark our data. And so, our average APR is 33.5% to make it comparable with other products at a 24-month term. The average APR that we've been seeing by competitors is in the range of 41.4% at 11-month term and with daily or weekly payments.

So, the net result of our product compared to benchmark....the result is in the 50% lower monthly payment with a Camino Financial loan opting being equal on the loan that we're giving to the borrower so, we're really giving our borrowers a lot of cash flow relief. Fundamentally, what we're doing versus anyone else...we can talk about tech and AI, but, fundamentally, what we're doing better than any (garbled) is we're giving our members the benefit of the doubt. If you don't mind, I'd like to tell you a little bit about our members and how they look like.

Peter: Sure.

Sean: So, we're talking about members...25% of them don't have credit history, immediate account balance is $2,300 in their account at point of financing and our average ticket size is $18,000 and there's a very large amount, I can't specify the percentage for purposes of their own security, are undocumented here in the United States. So, when you even look at those terms and parlay that with the credit profile of our members that are truly thin file, cash-based micro enterprises, not even small businesses, you're going to call that a micro enterprise when you're generating around between $200,000 to 300,000 in revenue per year, right.

So, these are micro enterprises and you give these terms to them, it's like God-sent, they're more than grateful and quite frankly, that's just the starting point once again. Our view is that while we think we're competitive day one relative to benchmarks, we think that we need to facilitate that camino, that path to more money at lower interest rates and over a longer term.

Peter: Okay, So then, tell us a little bit more about the borrowers themselves like what sort of businesses are they, what industries do they operate in?

Sean: Yeah. So, the big industries are construction, that's about 26% of our business; retail, 10% of the business; transportation, 10.4% of our business; restaurants and bars, about 9.6%; and then the rest is distributed to what we call, probably defined, professional services...when I say the rest, I mean, the next big chunk is professional services and they're your janitors, your landscapers that are serving the market.

Peter: Okay. So, I'm curious about this, particularly you say you've got some undocumented workers....I mean, a lot of them don't have a credit history so, what data do you use to underwrite these people. I imagine, you just can't say yes to everybody ......

Sean: No, we can't.

Peter: ...so, how are you.......maybe we'll just start with that, what data are you using when there is very little data available?

Sean: Yeah. So, one thing worth noting is I do want to challenge the notion in the market that there is limited to no data available. These businesses do have bank accounts.

Peter: Right.

Sean: Seventy five percent of them, of our borrowers, is actually a bigger proportion for the primary market, but our actual borrowers can actually get loans, 75% do have credit history, maybe thin file, right, and so we can do a lot like other industry leaders with bank data. Now, there's nuance to that have data, let's go back to the day transaction data. I mentioned that the minimum account balance of borrowers at point of financing is $2,300, I told you the frequency of transactions in that bank account may be a lot lower and a lot of other alternative lenders are comfortable lending to because they also want to see that transaction frequency, but there is data there, right.

Once again, after the credit....you know, not to forget about the credit score, we don't look at the credit score, but looking at the credit file, although thin, there is data there. We can look at credit utilization, we can look at credit history and we can look at types of credit, etc. So, I think there is data there, not to mention you can get really fancy and look at the metadata of your application, evaluate the user journey, usually, that's better to use not so much for the credit decision, but for fraud detection, and so, therefore, there is data available.

I don't want to give the notion that, you know, because our audience are people that are actively investing, or alternative lenders themselves, they get it and I don't want to give them the notion that the data sets are fundamentally different. Now, I do think, given our specialization in the market, given the fundamental benefit of the doubt that we're giving in our market......I think how we cut the data enables us to risk rank our model for the thin file, cash-based micro enterprises.

And it's not Latino-focused, one, we can't nor do we want to ever discriminate from that ethnic or culture standpoint, but it's worth noting that thin file, cash-based micro enterprises, there's nuance to that. And so, by specializing we're able to look at the data sets, I would say 80% of them are probably similar to that of other alternative lenders, right, and then we derive, given our specialization, some risk ranking criteria that helps us derive a credit decision.

Now, I will tell you something that we do that others don't do, Peter, is that given the cash-based nature of our business, we have to do something that's very prominent in emerging markets, but for X or Y reason, I don't hear it, or I rarely ever hear it here in the United States. This is a methodology called surrogate income underwriting. Now, surrogate income underwriting means you basically need to look at data sets and certain data points and derive from them what real cash is flowing through the business and the household.

So, for instance, let me give you an example. I can’t predict what Warren Buffet's net worth is based on the car that he drives, I think he drives a Cadillac, but when we're talking about evaluating credit for businesses at the base of the pyramid, right, you can, with a high degree of certainty predict what the real cash flow is based on using different data points because the disposable income is so limited for this demographic that you can make some really smart guesses. Based on that, not only can you make a credit decision, but more importantly, you can actually better understand what the capacity for repayment is for that given borrower.

That's probably one of the trickiest parts of this demographic, but we've been able to get really good at that and once again, this is nothing new, it's just very prominent in emerging markets where you have an absence of that trackable cash flow data that we're used to having here in the United States.

Peter: Okay. So, I guess what you're saying is one of the data points is what type of car they drive and how much that's worth and, obviously, a lot of these cars will have a car payment you can....I imagine, you can pull data on that information. But, I'm just curious about that, I mean, you say, that like the surrogate data is really....you're just trying to look for data anywhere you can get it, it sounds like what you're saying.

Sean: Absolutely, given our specialized view on this demographic, we're just going to use that data direct, probably different conclusions, of different.....we're going to find that data maybe in different ways and other alternative lenders are using it.

Peter: Right, right, okay. And so, how are these people coming to you, is this all 100%....like, I imagine, there's...I presume you have an app, or is it all on the web, or do people come and see you in person, I mean, how do the people fill out applications?

Sean: Our application is 100% online and 100% tech-enabled. Now, we just hit our sixth-year anniversary about a week ago and, Peter, there were so many people who have been lending into this market for many years before we started that would laugh us out of a room when we told them we were doing a digital-first, digital-only approach with our market...that they needed to see you, they needed to touch you and in the absence of that act, you would be able to earn their trust. Forget about the transaction fees, we can take that part out, but the trust element is a critical piece of the puzzle in acquiring this market at a low cost to make the unit economics work because, as I mentioned, our average loan is $15,000.

Other alternative lenders are about $25,000 to 30,000 so we have to work with roughly half of what they're working with, in terms of their earnings at least on day one. And so, what that means is we had to go tech first, we had to be tech-only and what we found is that....we were even pleasantly surprised ourselves that this market really has embraced a tech-enabled process, as long as we pair that with a very trustworthy brand.

So, I'm always a little embarrassed to tell people this, but came the idea to have our own mini series on Discovery Channel en Espanol called emprendedores which means entrepreneurs in Spanish. We have created one of the largest bilingual content databases in the United States and so if you Google prestamos para pequenas empresas which is small business loans in Spanish anywhere in the United States, we're going to be the number one ranked website there.

We're also rigging for other different terms that have nothing to do with credit, but has everything to do with helping businesses grow and be bigger and better than themselves. So, predominantly, we saw an opportunity very early, and not only be tech-first, tech-only, but also build our go-to-market strategy around that. And then, embellish that with the brand and authority that gives people the trust that they need because if they don't trust you, I can tell you right now, they don't trust you, they're not going to transact online.

Peter: Right, right. So, you're based in Los Angeles so, obviously, you're lending in California. Where else are you lending in this country?

Sean: So, we lend nationwide with the exception of New Jersey, North Carolina, Hawaii and Puerto Rico, but other than those states, we lend nationwide. Now, not surprisingly, the three largest states that count for 55% of our volume are California, Texas and Florida in that order.

And so, those are very prominent states with a high concentration of Latinx businesses, but, at the same time, it's worth noting that there are a lot of other businesses out there, 45% of businesses out there are also looking for loans outside of those three core states and they're fairly, you know, evenly distributed.

I would say probably New York is a distant fourth place, but still worth noting, Illinois as well, but at the same time, when you look at rest of the nation, you're pleasantly surprised to see the distribution. In fact, it's worth noting a little bit of a plug on our research report, we release a quarterly Latinx small business survey based on the application data that designates an ethnicity so, we can't include the non-designated application data, but with the designated application data we have about 27,000 applications.

We use that data to show the world where our businesses are distributed, what the average FICOs are, what the average revenue is, what are the trends in that data and you can see that geographic footprint in that report.

Peter: Right. I've looked at those reports. I think you do an excellent job, really provides a great service, I think, to the industry. So, I want to talk a little bit about the current state of play because you've been reading a lot in the press how…you know, we know small businesses are suffering.

They say it's been black and Hispanic businesses that are suffering more, those own owned businesses are suffering more than others so, maybe you can give us a very good insight into the Latinx community. Why don't you tell us a little bit about how they are coping, how they've coped over the last three months.

Sean: Yeah. So, just to show you some stats, research states that about 91% Latinx businesses won't be able to access the relief fund that are made available by the government. Forbes also had an article that noted that over 50% of black and Latinx businesses expect to close their doors if the current environment withstands for the next six months. And so, yes, we were very early in raising the flag to the industry and to the government that black and Latinx businesses are being left behind, not only in small businesses, but also in healthcare and in systemic injustice.

So, this is a very polarizing moment for these minority communities and the call to action needs to be made. We need to not only acknowledge that and put data around the market so people learn about it, but we also need to create nuanced and specifically designed products and services around these markets so that we can reverse this trend.

And so, to answer your question directly, yes, we are seeing our businesses hurt. I'm proud to tell you that our very quick response to this was leveraging that large content database and that team behind it and completely re-positioning Camino Financial and it's blog around a COVID hub, COVID and other relief resources hub because it's worth noting, as I mentioned, that many of our members are undocumented so we need to think broadly in terms of what those resources are, whether it's direct access to funds or other forms of relief, that enable them to grow their business. So, that's a narrative that we're hearing a lot and I will underscore that narrative.

Now, I do want to mention, Peter, that we also don't hear the second narrative as often. That second narrative is a narrative that black and brown business owners are resilient, they are as resilient as any other market here in the United States. Let me explain why. The reason why they're resilient and, yes, we just went through, before pre-COVID, an 11-year expansion market, but the reality is that many of these businesses, these underserved businesses have been living through many micro recessions in their own growth. Well over 80% of them operate in to low to moderate income areas, socio economic disparity gap has only amplified itself in these last 11 years pre-COVID, this is all pre-COVID.

And so, they know how to live in a recession-like environment. In fact, they don't just operate at a business level, they operate at a household level, and so the household could subsidize volatility cash flow of the business by, whether it's the wife, whether it's the kid now working for the business, but finding supplemental forms of income to subsidize the business at different points in times. The flexibility of these businesses, given how small they are to reinvent themselves and recover from these very difficult points in time.

And so, I will note that while we are seeing a market that has, predictively and unfortunately, was very predictable, and I have a lot of articles on this subject well before people started throwing about these numbers about 91% of Latinos and 95% of black aren't going to get the PPP funding and 50% will close their doors if this continues. Well before that, I was predicting that they were going to be left behind, but, despite that, I think in many ways, they also expect that and adjust accordingly. It's worth noting that because....I know one logical question is, how many of your borrowers did get PPP, how many of them got EIDL funding.

So, you know, when we talk about that I can tell you that, yes, many did not and I'm proud to tell you, we're actually actively putting our own research together to show you how creating that content hub, creating that direct channel communication with the market enables you to over invest in a substantial way in terms of those that do qualify for PPP funding, actually getting PPP funding.

Anecdotally I can tell you, many of our members did get PPP or EIDL funding and we're going to put some research out there to demonstrate how some of even the soft touches of education really made a world of difference, not just around the PPP funding design which does need some work, but also just being a real distribution channel content and capital to enable them to take advantage of resources that exist.

Peter: Right, right. I'm looking at your website on my other screen here and right, front and center, you talk about the Paycheck Protection Program, you talk about other relief programs, you've got a whole section here. So, you quoted this 91% number, I imagine, your customers, percentage will be much lower, those that are going to partake...by definition, I imagine, they're more educated and they trust you and they're going to look at what you've done.

Sean: That's exactly right. And so, we'll be releasing more information on that in the coming weeks, but I can tell you anecdotally, based on the data that I'm looking at, that that number is going to be a lot lower than what the market benchmarks are, 91% for Latinx is not receiving PPP funding.

Peter: Yeah, yeah, okay. We're almost out of time, but a couple of more things I want to get to. So, let's talk about the other side of the equation here. I read something about Goldman Sachs, how are you funding your loans, where is the capital coming from for these businesses.

Sean: Yeah. You probably won't be surprised, but we actually got our money from Mexico (both laugh). We needed to get money from investors that are equally willing to take that leap of faith in the market so we found that in Mexico. So, Credito Real is a publicly traded company in Mexico, it has a $2 Billion balance sheet lending business, multinational, with assets not only in Mexico, but in Central America and in the United States across different lending verticals, including auto financing, payroll financing and now small businesses.

So, starting at the end of 2018/2019, they partnered with us and we've really been able to fly since they were a critical part of our ability to really prove out the investment thesis in this market. And so to date, we've lent over $60 Million in loans and we're barely getting started. You know, pre-COVID, we were on track to do in the range of $100 Million this year and, you know, very much like any other of these businesses, we.....the market is big, $50 Billion so we still consider that to be very small, but, in the scheme of things, we are the largest Latinx-focused lender in the United States and we are barely getting started.

Peter: So then, I'm curious about....I imagine the loan volume is going down with PPP, with the crisis, but you've maintained a certain level of lending throughout, I imagine.

Sean: Yes, we have, but like the benchmarks that I've been hearing, volumes are down between 50 and 80% and we're within that range. We lend to businesses that are earning and we really need to recognize our (inaudible), you know, our private business is designed to expand a company that was growing. These businesses don't need growth capital, they need repeat capital and they need recovery capital which is at below market rates.

That's not sustainable for the long run, but finding new ways of changing our capital structure and the participants in that capital structure so that we can give better terms in the market even beyond relief and we could qualify that as recovering. So, we're actively working on that because the last thing we want to do is put our businesses at risk, especially during these times. Everyday, all day we're always about, you know, underwriting the loan for mutual benefit and so we need to be very thoughtful and careful about how we deploy capital during these times.

Peter: Right, right, okay. So then, as we look forward to, hopefully, coming out of this crisis sometime in the near future, when you look at what's on top for Camino, what's coming up for you, guys, what are you excited about?

Sean: What I'm excited about and if you don't mind, I'm going to share a very brief framework. The framework of our strategic thinking is that post-COVID's in three stages, the three R's. The first R is Relief, the second R is Recovery and the third R is Reinvention. And so, as we think about Relief, you know, in our case it's been a content play...predominantly, some fintechs have been able to be PPP lenders themselves if they have sufficient scale to be able to do it cost effectively. In our case, we did a predominantly content play.

The second one is Recovery, right, Recovery is really how can we design our products for below market return. So, work with different philantrophists, work with different players in the space that want to help this market and then design our products around that Recovery/Rebuild Capital, I'd like to call it that. So, right now, we're right in that stage so, we're actively talking about launching a Recovery Fund....actually, where you live, Peter, there's a..... (laughs) I'll let you know as soon as we get that going......

Peter: Okay.

Sean:....and so, to really enable Latinx businesses, particularly the undocumented, that haven't been able to even get access to a loan and let alone recovery.

And then the third stage is the Reinvention stage, this is the part that gets us all really excited. I can tell you that Reinvention is just going to amplify things that we've been identifying for a very long time, the use of tech and AI in order to not only automate our processes, but to make better, smarter credit and fraud models, the need for transparency in the process giving our borrowers the best market terms available, the importance in hybrid of a marvelous UX, UI, but one that super serves specific market niches.

The fourth element that I'll talk to you about in the Reinvention Stage is really coalescing our stakeholders, not just the alternative lenders, right, but the government, private investors and in my case, organizations called CDFI's, Community Development Financial Institutions. I think it has been noted in PPP 2.0 there had been dedicated allocations to CDFI's to lend into the underserved markets that we're talking about, but there's been a lot of under investment in these markets. The adoption to technology has been slow, with the exception of a few CDFI's out there.

Quite frankly, it's been hard for us to become a CDFI ourselves. I hope to announce in the next few months we too will be a CDFI. And then, how can private investors participate in this process, right, as it relates to creating tax incentives in order to decrease the cost of capital, how do banks play a role, how do we modernize CRA, the Community Reinvestment Act, which is really designed for small businesses in the 90's, you know, really anchored around businesses between branches in order to (inaudible), but, quite frankly, they've been closing branches and even banks are just going south. How do we modernize that?

So, that's going to be an area of our focus at Camino Financial and, you know, I do think there is a silver lining here. I even think the Black Lives Matter protest have really raised a lot of awareness on the need and disenfranchisement of Latin and brown communities and I think there are the best.....alternative lenders are the vessels in which we can enact that change, but we also still need to work with the government, we need to work with banks, we need to work with private investors to make sure that we construct through this capital and deploy this capital in very efficient means that are nuanced for this market.

Peter: Right. We'll have to leave it there, Sean, best of luck. I'll be following along with your progress closely and I wish you all the best as you grow your business.

Sean: Thank you so much, thank you for having me.

Peter: My pleasure, see you.

Now, these are challenging times for any small business lender, certainly, Camino Financial will be no different and I do appreciate the fact that, you know, Sean is already talking about the recovery phase of this crisis. He did mention how Latinx business owners have been impacted in a dramatic way during the crisis, but he is looking at the recovery phase and the fact that he is so ingrained in the community, it seems to me that he's got such close ties with many of his borrowers.

Those are the sort of things that are really going to hold him in good stead, hold Camino Financial in good stead as they emerge from this. I think, it's companies like those that really maintain a connection with their customers and the borrowers really appreciate the extra efforts they've done. I think they are the companies are going to come through this crisis as well.

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

Today's episode was sponsored by LendIt Fintech Digital, the new online community for financial services innovators. Today's challenges are extraordinary with the upheaval affecting all areas of finance. More than ever before, we need to come together as an industry to learn from each other and make sense of this new world. Join LendIt Fintech Digital to connect and learn all year long from your peers and from the fintech experts. Sign up today at digital.lendit.com

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