S&P Global
Market Intelligence

Pagaya Technologies Ltd. NasdaqCM:PGY

Special Call

Tuesday, March 26, 2024 5:00 PM GMT

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EXECUTIVES

Evangelos Perros
Chief Financial Officer

Gal Krubiner
CEO, Co-Founder & Director

Sanjiv Das
President

ANALYSTS

John Hecht
Jefferies LLC, Research Division

Presentation

John Hecht
Jefferies LLC, Research Division

I'd be very, very pleased to have Pagaya, the management team of Pagaya on the phone here, to do a fireside chat. Just in light of a lot of the activities that have happened recently, we thought it would be helpful to get the management together, answer questions and give us an update on the business. I will let the management team introduce themselves, but we have Gal Krubiner, the CEO and Co-Founder, Evangelos Perros or EP, the CFO; and Sanjiv Das, the President of Pagaya. And again, I'm going to let them introduce themselves, but before that, I need to read a quick compliance requirement.

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All right. Thanks. So again, welcome, guys. I'm going to let you introduce yourself. But before we do that, we are going to do a fireside chat here. And if anybody wants to ask questions, if there's time at the end, what we're asking you to do is send the questions to ir@pagaya.com. We've already received some, and we will try to get through as many questions as we can. So with that, let's kick off with an intro of our speakers.

As I mentioned, joining us today, we have Gal, EP and Sanjiv. I'm going to turn it over to them to do an intro and an overview of the Pagaya business model, including the problem they're really looking to solve with the business model. How the product works? How the revenue is generated, throughout the process of the product cycle. And Gal will also present some slides here to give an introduction.

So with that, why don't you guys introduce yourself and go through some of the introductory slides.

Gal Krubiner
CEO, Co-Founder & Director

Perfect. So thank you so much, John, for having us. We are definitely excited to be here and appreciate the time and effort for putting that together. My name is Gal Krubiner. I'm the CEO and co-founder of Pagaya, founded the company in 2016. Before that, I was a structured product banker at both UBS and before that at Deutsche Bank. So 10-plus years of banking and banking industry and the financial industry before building Pagaya today with my 2 other co-founders that are coming from the tech industry. Evangelos?

Evangelos Perros
Chief Financial Officer

Hi, everyone. This is Evangelos Perros. I go by EP. I have been with Pagaya for almost 3 years as CFO. I've held a couple of leadership positions while at Pagaya. Before that, I was a Managing Director or Head of Business Planning and Analysis at Apollo Global Management for 5 years. And before that, spent over a decade at JPMorgan Chase, most of the time as an M&A investment banker.

Sanjiv Das
President

Thank you, John. So my name is Sanjiv Das. I joined most recently as President at Pagaya, about 5 months ago. My background is in running consumer businesses in the U.S., in Asia, Australia and Europe, pretty much most of the world and in running capital markets in places like Morgan Stanley in the U.S. I was CEO of Citibank's mortgage business during the financial crisis, which some of you might recall, we landed extremely well for Citi's consumers, Citi's regulators and Citi's shareholders.

Before that, I was at First Data and -- which is, some of you might know, one of the world's largest consumer payments company, which is now part of Fiserv. We took First Data public in 2015 for KKR. And most recently, I was CEO of Lone Star's Caliber Home Loans, which we built from a $15 billion business into an $185 billion originator, the fourth largest mortgage company in the country, in fact, larger than JPMorgan's U.S. mortgage business and sold it successfully to NewRez, Fortress and SoftBank, that group. So I ran a lot of innovative businesses and responsible consumer franchises.

So back to you, John.

John Hecht
Jefferies LLC, Research Division

Great. So I'd ask you guys to maybe put some slides together to give -- for some of the participants on the call maybe an introduction and a brief overview, a brief update, too.

Gal Krubiner
CEO, Co-Founder & Director

Perfect, John. Thank you so much for that. I think when you start to speak about Pagaya, and let's start from the 30,000 foot, it's really what is our mission that we're trying to solve. So by simply putting it, we are trying to deliver more financial opportunity, to more people, more often. And we're doing so by connecting our unique product to over 29 lenders in the U.S., very big lenders, that we are helping fund loans through their systems. We are doing that with 110 funding partners that actually is part of our funding mechanism, and by doing so, we have managed to fund over $20 billion in 50 different transactions, and we are now at a run rate of $9 billion as we speak about the Q4 numbers.

That has brought Pagaya to have annualized revenues of over $800 million and an annualized adjusted EBITDA of $135 million. So clearly, the very strong performance and the ability to fund and to help more people to get more financial outcomes is actually a very accretive business for Pagaya.

In the last few months, we have actually had the pleasure to announce the extension and the joint of U.S. Bank, Exeter, Westlake and Top 5 auto captive to be part of our 29 lenders. And next to that, we have announced, which we'll talk about it later, almost $300 million credit facility with the most marquee investors in the world in between them BlackRock, UBS O'Connor and JPMorgan.

But the best way to speak about what Pagaya is trying to solve is really look on the problem that exists in the U.S. So you will be surprised, but still, 42% of the U.S. consumers are getting either denied for a financial product or denied for the credit they are actually requesting. And what we are trying to do, the solution that we are offering, the connectivity to the banks is really to ensure that lenders do not leave good borrowers behind. By helping the lenders to add these borrowers, retain the customer relationship and to offload their credit risk that sometimes doesn't suit for their balance sheets into our funding network.

And I think when I show these slides usually, the biggest misunderstanding of the thing that is important to name is who are these borrowers. So one will think they are the ones who are getting declined or at the very skirts of the actual U.S. economy, but the actual truth is that these are good Americans that are having an annual average income of $120,000. Usually, they have 17 years of credit history and they are consuming different type of consumer credit for the last 10 to 15 years.

So when you think about it this way, we are really trying to fill a gap that exists in the financial industry, in the U.S., by not competing with banks or creating another fintech, but rather by enabling the lenders to do so. And as we said, there are over 29 different lenders that actually connected to us through an API that is allowing us to drive and to push big numbers of consumer credit to the people who needs them so much. And as for now, we have originated over $20 billion of debt.

In order to appreciate how all of that works and how the product is actually functioning, the best way to explain it is by looking on example. So we put here a simple example of Jane, that she goes, let's assume for U.S. Bank branch somewhere in North Dakota, and actually applying for a loan. And when she applies to a loan, in that process, the bank or the different lender is running through the creditworthiness and sometimes for different restrictions, they have a FICO cut off onetime bankruptcy in the past, Jane could be declined. In 42% of the cases, Jane could get a rejection for the loan.

Pagaya that is connected seamlessly behind the scenes to the systems -- to the loan origination systems of this bank, in our example U.S. Bank, is actually passing all the information of Jane to Pagaya, and if Pagaya, with unique data capabilities and algorithms that it has, finds Jane actually to be creditworthy even if her FICO was 719 and not 721, we are extending an offer to Jane, but we do it through U.S. Bank. So U.S. Bank is getting our approval. They are showing that to Jane. Jane is getting more or less the same terms that she would have gotten if she was approved under the regular U.S. Bank umbrella. She doesn't even know that Pagaya is behind it. And let's assume she's actually getting the loan. She is becoming , and that's the most important thing, John -- she is becoming a lifetime customer of U.S. Bank. So Jane got a loan, and she's very happy about her $10,000 that she was applied and got for. She actually got it from the lender she was looking to get it from and that's the power of that product. And in the same time, the bank could keep the customer and Jane will be applicable for many more things, and the deposits are being kept with the bank and other type of loans that she might require in the future.

And the last piece is that the funding goes through Pagaya, which we'll talk in a second. But at the end of the day, is sitting on the balance sheet of very big institutional clients that you will know them or label them as a private credit shops.

So when we understand that and how the product works, the other two things that left to discuss about is, first, how Pagaya earns money. So Pagaya earns 3% to 4%, which is what we call our fee revenue less production cost for every $100 of loans that we are issuing. That fee is actually being paid from our lending partners for helping them add more borrowers. So you can think about that, that they are thinking about it as a cost of acquisition. And actually, 63% of the fees we generated had came from that revenue stream.

And the other piece, the other 37% are coming from our funding partners as we help them to invest in a scalable, very diverse AI-enabled assets. So actually having the ability to invest in these assets are coming from the fees that the investors are generating. So with that in mind, let's move to the next point, which is how we are funding all of these loans.

So unlike traditional funding models, we raised the funding before the assets are created. We call it the pre-funding model. Why we do that? Because we are risk averse. And we like to minimize as much as possible what we call the liquidity risk. Usually, lenders, when they are originating loans, they are piling that on their balance sheet, and therefore, at some point, they need to offload it to the market. The risk that exists in this time frame, if markets move a lot, is that you will end up owning a lot of loans that are being misplaced or mispriced, and therefore, you need to sell them at a heavy discount.

So by introducing a very unique pre-funded model as the one that we are operating and as you can see, more than $20 billion has been actually funded through this with over 110 unique investment firms that participated, made us the biggest personal loan ABS issuer in the U.S. We are reducing the dependency on market movement and allowing to have a very sustainable and strong business model.

Now to the last question of how we are growing. What's the growth strategy of Pagaya? We spoke what is the mission, which is to allow more borrower to get more credit. We spoke about the way we do it, which is how the product works. We spoke about how we earn money and how we fund the loan. And then the last piece, to complete the puzzle, is really how we grow?

So Pagaya grows again differently than other B2C lenders. We are growing by adding new lending partners to our network, signing up more banks as Klarna, SoFi, U.S. Bank and others. Now the unique way that we do it, which we do it across personal loan, point of sale and auto, is that this is a very tech-forward or the way tech companies will think about growth. Because let's speak again for a second about the traditional B2C lender. They have two main ways to grow their origination. One is to spend more money on marketing. And therefore, more people will come to their funnel and will be able to take loans. The problem with that strategy, while it's good, it's very expensive. The other strategy that usually B2C lenders are pursuing is to reduce the price of the loan. By that, they are getting more approvals under their belt and, therefore, increasing the origination. The problem in that strategy, that is risky. That if you price it too deep, you might miss the risk pricing adjusted that you need to have for the assets.

Especially, these things are becoming more pronounced in a different macroeconomical environment that to spend more money is tough or to lower the price is challenging. So to the right, you see actually the outcome of this. Pagaya has managed to grow 40% the origination of what we do because we landed more banks, because we landed more lenders. While traditional B2C peers will have seen a reduction of 30%, 40%, 50% on the origination. So we have just showed you that these type of things are helping us to have a consistent financial performance through market volatility -- through macro volatility, showcases the durability of our business model. And as you can see, '21, '22, '23, that all years would have been a macro volatile years, we have continued to grow. And when you think about it even from the adjusted EBITDA perspective, we have shown that even we can be at a very strong financial performance. '22 was a year that we needed to adjust for the new environment. But as you can see already in '23 and in our outlook for 2024, we are actually creating very high margins.

So before we go into the Q&A, I thought it makes sense just to put a little bit of context on where we are standing in Q1 of 2024, which we are obviously reaffirming our Q1 '24 guidance and the full year '24 guidance. But more than that, we are actually saying that we are on track to deliver our 2024 plan. Let me take you through the high level, and then we'll go over the Q&A.

So the most important piece is the lending partners and the product. We are seeing the cohorts of the 2023 coming in line with the ramp-up that we are expecting. We see that we are on track to deliver 2 to 4 new lending partners this year. And maybe the most interesting piece is that we are in final negotiations with a bank to sign into our point-of-sale product, which is a very strong and important piece to illustrate the power of our strategy to tap into banks and to become their enablers and lenders in yet another market that we didn't have so far a major bank in the U.S.

The second piece and a question we get a lot is what's the situation about the credit performance? Of the book of Pagaya, of the things you are retaining on your balance sheet. So the bottom line is that today, the pieces that we are retaining on our balance sheet is actually accretive from economics perspective. We see the early stage delinquencies for the recent personal loan vintages at the lowest level they have been since January '21, which implying a 9-plus percent return on the assets. We see even more mature indicators for the 2023 vintages. The months on book 6 to the months on book 12s at their lowest point since April 2021. So if you think about it, our latest transactions are actually accretive because the ROA of the assets is 9% to 10%, while the cost of capital has actually reduced and became sub-

8%. So all of that are an interesting and great news for our credit performance and the balance sheet, which we'll talk more in the Q&A.

The third, and the last point, it's about our funding and financing strategy. We are on track to achieve the positive cash flow with the continuous growth of both our business and reducing our net risk retention on the balance sheet. We have secured, since the start of the year, almost $2 billion across 4 different transactions. We have landed $100 million of new secured borrowing facility with Jefferies, and we have completed, and this is a step function change for us, a whole loan sale program, with an initial $50 million that resulted in a very low retained portion of below 1%.
So just putting in context our Q1 -- our Q1 momentum as we are heading into the year and there are a lot of things that we need to achieve and to execute. So by that, John, I wanted to hand over to you and to allow you to have the questions that you're looking for.

Question and Answer

John Hecht
Jefferies LLC, Research Division

Starting with the partners and products, and I guess this is probably a question for Sanjiv. Can you give us an update on the progress you're making for each of your products, I guess, the personal loan and the auto, recent partnerships you signed and Gal referred to this, but some of the momentum you have, achieving 2 to 4 new partners per year.

Sanjiv Das
President

Sure, John. And thank you again. John, I feel very confident about landing 2 to 4 partners this year. In fact, I would say that our pipeline is like significantly stronger than that. And I'm sure we will land that relatively easily. Let me give you a bit of a background on why I think that is the case.

I will say that the demand is huge. And it seems to be like across the board from banks to fintechs to auto lenders and POS lenders, as Gal just mentioned in the context of POS. There's absolutely no question in my mind that every lender wants to access more customers. And I'm talking about good creditworthy customers left behind by mainstream lenders because lenders are either constrained by, for example, where Basel endgame is going or they are constrained by using outdated credit models, and they have to say no to good customers. So at Pagaya, what I have figured out is that we use our models, our data and our technology and as well as our access to ABS markets, obviously, to provide consumers credit in personal loans, auto loans and POS lending that mainstream lenders would miss. And so lenders rely a lot on Pagaya in how we bring credit in a very price appropriate and a very responsible way.

I'll give you an example. We were recently talking to the CEO of a very large consumer bank. As you would expect, I happen to know a lot of them from my own background. But we are recently talking about their personal loans business and the whole discussion was about how we replicate what we plan to do for them on the personal loans side in expanding credit to more consumers, also to their POS business, which is what Gal was referring to. And I know and we can see that the same discussion has been replicated in auto -- in all lending businesses that a bank has. And so it's a very significant initiative for us to be able to sign up banks and move across the value chain in all of their lending businesses across the whole Pagaya repertoire as I would say.

And by the way, again, it wasn't just about approval rates. Clearly, Pagaya was also solving for the fact that they were approving more merchant approval rates at point of sale as well as solving for financial inclusion, as Gal mentioned. So we are talking to fintechs about their -- I also want to mention we're talking to fintechs about their entire value chain, so not just across different products but across the value chain. So how can we responsibly lend to their existing customers, for example, not just new customer flow, folks that would get rejected because of outdated credit models. And so our penetration in existing customers is also rising in a very significant way. And the same discussion is going on in auto and POS.

So net-net, very confident about landing 2 to 4 lenders this year. In fact, could be even more. Very strong in our PL side of the business. And look, we've demonstrated great success with partners like SoFi, Klarna, Ally, Westlake U.S. Bank and so on and so forth. And we are basically replicating that model across a very deep pipeline of large money center banks, regional banks, auto lenders, fintech lenders, and point-of-sale lenders, which is a rapidly evolving business, as you know, who are redefining their business in a capital efficient way with the Pagaya solution. So net-net, super confident of getting there.

John Hecht
Jefferies LLC, Research Division

Okay. That's helpful. I guess moving on to credit risk, which I think is the key topic that people are focused on here. Gal you mentioned you're seeing -- you cited that some of the recent vintages, you're seeing delinquency trends at all time lows or at least since early 2021. Can you speak to more what you're seeing in the health of the customer? And then kind of as a side track to that, in terms of your ABS deals, how are they performing relative to triggers? And maybe talk about the different vintages there.

Gal Krubiner
CEO, Co-Founder & Director

So let me start with what we see in the economy. As you can imagine, the fact that we're sitting with getting data in live, real-time from 29 lenders, gives us a very unique perspective on how the evolution of the economy in the U.S. and the health of the consumer is manifesting itself. So usually, what you will see is the different part of lenders, they have a very narrow way to look on their customers. And historically, if you were like an AmEx and therefore, focusing on the traveling high-end customers, you will be very knowledgeable about that part. But if you are a different lender with a different type of population, you will see how they react specifically.

So all in all, what we are seeing is very wide into where we are seeing. And the simple way to put it is the U.S. economy consumer for now is in very healthy and stable situation. And when we think about the places where Pagaya is operating in, which is around $120,000 income, the 670 and 680 FICO. We are seeing a very strong reduction of delinquencies trend from as late as Q4 2022 and more pronounced since the start of 2023. So for us, 2023 is a year of stability that actually, the delinquencies are coming in line with what we expected and much lower than the '22s and the '21s.

Now to that, I will add that as we see and starting to see the '24, that trend is continuing. So it's not something that has stopped now. You will mention and I'm sure -- and this is right, that there is a little bit of seasonality effect because we're now at the tax season, so it's a little bit better. But the numbers we are seeing are actually getting back to pre '21 levels, which were very strong numbers of 9%, 10% return, which is in line with what we are expecting.

Now to your question about triggers, et cetera, even when you speak about the '21 vintages and the '22 vintages, which were, as you know, market-wide underperforming, none of them has hit any EOD trigger in Pagaya. So from a way we think about it, obviously, is in a relative value because unfortunately, as much as we are good, we cannot really anticipate how the economy will be in the future. We don't have a crystal ball. But we can know that we are designing for every case to be a better off.

And even when you look on the vintages of '21 versus other originators' vintages of '21, you will see that Pagaya has a very strong edge in a pure alpha per se. And therefore, we didn't had any bond that is lower to CCC or any breaching of any trigger for that.

So summarize all of that, '24 is showing a very strong momentum on the credit side. That, coupled with the lower cost of capital that we are seeing, especially on the investment-grade piece that is coming in line and people are actually -- spreads are becoming lower and lower, is creating for us an accretive piece that we are putting on the balance sheet. We see that trend continuing. Obviously, we're monitoring that very carefully, like a hawk. And when you think about the previous vintages, the '21 and '22, while they are not great and they're still causing us some impairments and we speak about it later, they are not near to the breaching of the different EOD triggers or anything else you will think about. And relative to the others, we actually had a very strong performance.

John Hecht
Jefferies LLC, Research Division

Okay. That's a good segue to my next question is, moving more specifically to the exposure you retain on your balance sheet. First off, what returns are you earning on these residual pieces? And what is the credit exposure? And then how -- maybe tell us how you recognize credit risk or losses as they occur.

Evangelos Perros
Chief Financial Officer

Sure. I'll take that, John. Thanks again for hosting us, and thank you, everyone, for joining today. As you heard from Gal, right, with improving asset performance and lower cost of capital, the assets that we're currently booking on the balance sheet are expected to generate positive returns and accretive economics. So let's step back, though. If you look at the performance of these retention investments that we put on the balance sheet, obviously, they can fluctuate. There will be times where they can experience losses, and times they can be positive returns. Ultimately over the cycle, it will still be positive overall to the business.

Now the entire market experienced losses on their 2021 and 2022 vintages. And even relative to where we are today, we may continue to have some volatility on those prior vintages. But we did make specific adjustments and took action in late 2022.

First, we lowered our conversion rate by almost 50% and most importantly, shifted to a much stronger borrower profile over the last few quarters. As Gal mentioned, the average income of that borrower is $120,000 of average income per year. So as a result of those actions, the loss indicators on our latest vintages are at the lowest point, again, as we mentioned, since early 2021. Ultimately, what we're doing today is the following: we are targeting 9% to 10% return on the assets that we generate, with a cost of capital of approximately 8% today, which effectively that implies a mid-teens or higher return on our newly retained assets on the balance sheet.

John Hecht
Jefferies LLC, Research Division

Okay. And then just really maybe tell us how losses are recognized, as the second part of that question, in your income statement?

Evangelos Perros
Chief Financial Officer

Yes. So if you look at where the losses get reflected in our P&L first, that would be in the other income line. The other income line primarily includes interest expense and fair value adjustments of those investments, loans and securities. And as a reminder, in Q1, we switched our accounting standard to available-for-sale securities. In order to provide more transparency to the market. And that was also partially driven by the market volatility at that time and bank exposure to the held-to-maturity portfolios.

So obviously, as I said before, we have seen volatility in other income driven by our 2022 and '21 vintages. And I think based on the latest performance, ultimately, we expect that to -- what we're retaining today to be accretive on our overall economics. So most of those losses, again, will be in the other income.

And against that, if you look at what's currently on the balance sheet, there is the gross investment of loans and securities. And against that, there is a minority interest. So the delta between those two numbers is what's truly the economic exposure of Pagaya to those investments in loans and securities.

John Hecht
Jefferies LLC, Research Division

Okay. And I guess that's another good segue to the next question is, specifically to the exposure you retain on your balance sheet. What returns are you earning on these assets and the credit risk in the -- in terms of your risk retention requirement? You mentioned that you closed two new transactions that optimize your retained portion and your use of equity. Can you speak more broadly to your strategy for risk retention? How much you're putting in on each transaction? How you finance those requirements? And which tranches are you taking when you're buying a piece of the securitization?

Evangelos Perros
Chief Financial Officer

Yes. So let me start with our strategy on risk retention. The strategy is very simple. It's to lower the net retained percent on our funded volume. The way we think about it is the net cash we use for risk retention is effectively the amount that we invest in those deals, in our deals, less any secured financing or other third-party funding we get against those assets. This is where we track against. This is our KPI, our net risk retention contribution.

Let me give you an example. In our last $800 million pay deal we just did, we had a net retention of 6%. And what actually was -- what we retained from that transaction was more than 50% in notes and the rest in equity or residuals. In addition, the new funding structure that Gal mentioned, of the $50 million trade that we're putting in place, we retained 1%. So that basically drives the overall average retention even lower, and we actually expect to scale that program significantly over the following quarters.

In terms of -- as you think about the size, the contribution, which tranches we invest in; we obviously go through a very disciplined approach around that decision, taking into consideration, obviously, market dynamics and specific deal attributes. We have seen a very meaningful shift in 2024. The pricing and the demand has been improving. And we see that being reflected as new investors coming into our deals, and the spreads tightening on the higher -- on the debt tranches.

Based on where we sit today, and the interest that we see from investors and their decrease in cost of capital, we do expect these trends to continue. We are committed in growing these types of funding sources and, therefore, lower our net retained portion. When you take that and combine that with our growth in our FRLPC and growth in the operating cash flow, that sets us on track to become cash flow positive.

John Hecht
Jefferies LLC, Research Division

Okay. I guess that was going to be my next question. So maybe try to avoid some redundancy, but how do we think about these -- the risk -- you mentioned the risk retention has kind of grown relative to the prior years because of volatility in the market last year. How do you think about that? And as you grow your network volume in context of your intermediate-term goal of '25 -- of positive cash flows by '25. And how do you define this metric? And maybe give us a little bit more color on how you bridge to that gap?

Evangelos Perros
Chief Financial Officer

No, that's a great question. So again, I want to state our plan is to get to cash flow positive by early 2025. And the way we look at that cash flow generation is as cash flow from operating activities, less what we retain net of financing against those investments. Now let me put it into perspective, just to understand a little bit where we are today.

If you think about the net risk retention, let's think about it in the context of our FRLPC generation. On a run rate basis, in our personal loan portfolio, we are today at a blended approximately 5%, 5.5% net risk retention. That compares to 5.5% FRLPC we're generating on our personal loan business. So on a marginal basis, we are cash flow neutral on our most mature product which represents more than 60% by the way, of our total network volume. And by the way, as you know, at Pagaya, we don't earn fees -- we earn fees from 5 different asset classes. And some of them do not even require ABS funding. So if you think about it on a, call it, total volume basis, we're actually trending at a net risk retention of 3% to 4% while also earning 3% to 4% FRLPC.

And by the way, what we mentioned before, this is important, based on the assets that we generate today, what we retain upfront on our balance sheet, we expect to get that based on the cash flow -- on the credit profile on the profile of those assets, what we generate today, what we retain upfront on our balance sheet, we expect to get that cash back over the life of the investment. So think about it a little bit as a long-term working capital, which, over time, further minimizes our net risk retention.

Now speaking specifically overall to cash flow, how we're going to get to cash flow positive. There are basically 3 key components on our plan. First, continue the FRLPC growth as we deepen our monetization of our lending partnership and our products. Combine that with operating leverage on our business, that will drive continued increase in our cash flow from operating activities. Combine that with the third component, which is the increased capital efficiency, that's the path to cash flow positive. And by the way, as we said in our Q4 earnings, we're laser focused on driving that capital efficiency in how we fund the growth.

Gal mentioned -- again, the transaction that we just did, which is a step stone for us when we think about the funding and how we're going to lower risk retention, that transaction had 1% retained on the full volume of the deal. And this type of structure today funds approximately close to 10% of our personal loan volume. As we scale this program, we're going to continue to drive our debt net retention lower. And we're already executing some of the -- as you've heard us say many times, we continue -- we're already executing on our plan to increase FRLPC and I'm happy to talk more about how we're doing that. But when you combine that -- yes, when you combine that with a lower risk retention, we're creating that path to become cash flow positive.

John Hecht
Jefferies LLC, Research Division

Okay. So let's talk about FRLPC. And you just touched on it briefly, and you talked about it in the presentation. Talked about on your last earnings call that you're focused on deeper monetization of your lending partners. Can you focus more -- give us a little bit more color on the drivers of your FRLPC by line and the impact of partner and product mix? And then I want to ask about other income in a second as well.

Evangelos Perros
Chief Financial Officer

Yes. Happy to do that. So Pagaya earns fees from both lending partners and our funding partners. That's what differentiates Pagaya relative to other originators. We both -- we earn fees from both sides. For new loans originated with our product, Pagaya earns a gross take rate of 9% to 10%. When you account for variable production costs incurred by our partners, effectively Pagaya earns a total of 3% to 4% in net fees. This is the fee revenue less production cost, right? That's the measure of our, call it, gross profit.

Now we earn fees on the lending partner side, primarily through the use of our technology that enables the origination of those loans and the addition of new borrowers to the customer base from our lending partners. And over 60% of our total FRLPC in this time -- in this type of the time of the cycle comes from our lending partners. And this -- think about this reflects the value they provide to our lenders. These lending product fees are very sticky as a result of the unique value proposition to our lending partners, right? They have the ability to retain their customers, extend credit, obviously earn economics while basically taking no balance sheet risk. And to speak to the success of that and the stickiness of the product, we have 100% retention of our lending partners since we started the business.

Now we also earn fee from our funding partners related to the capital markets execution, i.e., upfront pricing of ABS transactions, management fees, administration fees, performance fees on financing vehicles. And obviously, in this time of the cycle, given the elevated cost of capital, that sort of at the lowest point it has been.

In terms of product mix, personal loan continues to be our largest and highest margin earning asset. I mentioned before, we're earning 5.5% FRLPC in margin. And then auto and POS businesses are investment areas for us and growing substantially. And we basically have the playbook to replicate similar margins over time as we did in our personal loan portfolio.

John Hecht
Jefferies LLC, Research Division

Okay. And then I mentioned I wanted to ask about other income. You mentioned that because of the volatility and the variability in the market that, that had some incremental expenses running through it. How do we think about that going forward, given some of the comments about credit quality? I mean, will that -- would you be earning potential gains in that line item? Or how do we think about that over the course?

Evangelos Perros
Chief Financial Officer

Yes, yes. Let me repeat that a little bit. I came across. So first of all, this other income primarily basically includes interest expense, as we said before, and the fair value adjustment of our investment in loans and securities. I mentioned before, we switched to the available-for-sale securities in Q1 of 2023, and we have seen volatility in that line item driven by the 2021 and 2022 vintage performance. Where we see today, even though we may see some more volatility in those previous vintages, the stable performance that we're delivering from -- the credit performance that we're delivering on our more recent vintages, basically makes us to believe that today, where we see it, we are retaining assets on our balance sheet that are basically accretive on our overall economics.

John Hecht
Jefferies LLC, Research Division

Okay. So that -- so the -- you have a mix that have some positive performance in more recent vintages and maybe some lingering performance in the [indiscernible].

Evangelos Perros
Chief Financial Officer

Correct.

John Hecht
Jefferies LLC, Research Division

Then let's talk about the liquidity profile and your new recent capital raises, both the debt and equity, maybe talk about the rationale and the use of proceeds and why you guys did the capital raise now?

Evangelos Perros
Chief Financial Officer

Sure. Let me just step back first and say that -- from our perspective, we have a very strong capital and liquidity position. And as we continue to execute on some of these capital efficient funding structures, this will be basically the driver for us to get to positive net cash flow in 2025.

Now let me step back and talk a little bit about the financial strategy overall. And talk about all the things that we executed -- as you may have seen, right, we have been very active, the things that we executed over the last few months or quarters.

From a financial strategy perspective, we will always continue to evaluate opportunities to strengthen our liquidity while fueling profitable growth, whether organic or inorganic, and make an effort, obviously, to continuously attract new institutional investors in our shareholder base.

Now if you look a little bit at the history, all the things that we have done recently are part of that strategy. Over multiple quarters, we have delivered strong financial performance, quarter after quarter, and shifted to strong adjusted EBITDA profitability. In early 2024, we executed on the credit facility in the term loan. What did that do for us?

First, provides even more strength to our capital position and liquidity, while providing growth dry powder to the business. From a financial risk management perspective, we pushed the maturity of the corporate debt to 2029 by replacing the previous revolver that was coming due in 2025. And obviously replaced it with a facility that was much better fit for the size and the scale of the business where we are today relative to our overall evolution as a public company. But more importantly, that was led by marquee investors like BlackRock. And that vote of confidence, we actually wanted and expected to transfer over to other [indiscernible] like prospective shareholders, partners, lending partners and investors. And in fact, some of that drove some of the, call it, reverse interest in the stock, that started -- basically drove the recent transaction.

All of that was also supported by a couple of other structural components. One, the reverse stock split, the change in the headquarters, the filing of -- the voluntary filing of Qs and Ks. All of that will enhance the marketability of our stock. So let's talk a little bit about the equity raise.

We had inbound interest from 3 long-only fundamental investors. So we're opportunistic about that raising this capital in order to attract new institutional investors and fuel growth. While the short-term technicals worked against us, and we're not happy about that, the fundamental benefits are still very much aligned with our financial strategy. With all of these actions and everything that we did in that -- we have done in the last few months, over the long term, we strongly believe that, that will drive shareholder value.

John Hecht
Jefferies LLC, Research Division

Okay. And maybe turning to the investor network. Maybe give us kind of characteristics of the investors? And how do you kind of -- you guys have very large goals in terms of getting to your intermediate-term target. Maybe how do you bridge the kind of characteristics? And is there sufficient liquidity in the market and interest from that side to get to your intermediate-term goals? And will it be a different characteristic of investors as you move through that path?

Gal Krubiner
CEO, Co-Founder & Director

So John, I will take this one. As we think about funding the business, I think by now, it's very clear that on the consumer credit, especially on the capital markets, Pagaya has the strongest, deepest relationship products, trading capabilities, everything. So when you think about that and how deep can one go in the market, Pagaya is by far, #1 of that.

We have over 110 investors in our platform, in our funding network. And think about that, that it means that almost everyone who invests in consumer credit, invest in us in some shape or form. Now the important thing that happened in 2023, it was -- people underestimate how much important this year was. The stability that we managed to drive through our product has brought a lot of confidence back from the things that happened in '21 and '22. I think we did a tremendous amount of work to be able to hear our investors, we change our structure a few times and understanding what are the right efficient place to give the right audience, which is the most marquee investors you can think of, to get exposure to the asset while keeping the right confidence and sustainability and durability, which is the most important piece for Pagaya, throughout the cycle. It's actually a very strong proof point that even in tough macroeconomic environment, we know how to do that.

Now as we think about it going forward, we are having now in our bag, the fact that we have shown to the world that we know how to treat it and how to treat ourselves and our funding partners. And people appreciate that and a lot. And that is really the basis of how we are thinking about the $25 billion of production. I'd like to call it the 777. We are not thinking that personal loan is going to be a $20 billion product. We're not sure that for that we have enough liquidity in the market. But we have $7 billion in personal loan, $7 billion in POS and $7 billion in auto is something that is very doable, achievable. And as EP said, we have the playbook for it.

So we are working with the rating agencies, and we are working with the structuring, and we are working with the understanding of what the capital market needs are to meet that, and we have proven that we know to do it in scale. So as we think about our medium-term goals, $25 billion is something that we believe in the common structure with the current capabilities, we actually can support. And as we think about the things we discussed here today, 2025, becoming cash flow positive, it is understood that all the retained and the things you need to do for that are actually going to be part of the operational working capital.

So all in all, we had a very thorough process and strategy into that. These are our backgrounds. We are funding people. I mean this is a crucial thing and time in that. You heard Sanjiv speaking about his capital market background, you heard EP speaks about his days in Apollo. So we are very confident in our ability to bring all of that to light and to continue to execute based on our plan.

John Hecht
Jefferies LLC, Research Division

Okay. So I did have -- one final question I'll ask, but we've got a couple of minutes, and I want to ask the last question to ask. So if it's okay with you guys, I might go through a couple of the inbound inquiries we got in the Investor Relations site.

Okay. Some of your peers are talking about deterioration of the prime borrower. Are you seeing similar trends? And what is the average credit profile of your borrower?

Gal Krubiner
CEO, Co-Founder & Director

So I think I'm going to surprise you with this answer. We don't see the same trend. But we don't see the same trend because we're not dealing with the higher FICO type of borrowers. What we believe is the underlying thing that people are seeing in the economy and our data is actually saying so, is that when '21 and '22 happened, people have shifted -- they have shifted a lot of their focus from originating inside the 640, 660 FICO to what they consider to be more safer type of borrowers. And therefore, many of the lenders has went to chase the FICO score, 680 to 700, 700 to 720, 720 to 740 and so on and so forth. That has created in return a situation where there is more mispricing in the higher FICO than it used to be in the medium FICO where Pagaya is operating in 2023.

So the straight answer to that, John, is that we don't think it's being driven by economy. It's being driven by demand and supply in the market. And when you have too many lenders trying to chase the higher FICO, more likely than not, you will be in a situation where you're approving more and, therefore, the losses are piling up. The correlation between the percentage of lenders that are actually lending in the different Tier 1 versus Tier 2 versus Tier 3 vowels. And their new losses on the origination is so high that it gives us a very strong understanding that it's actually a pricing mechanism rather than economy situation. So that will be to that.

And on the characteristics, we are -- our average FICO is the 670, 680, the $100,000-plus of an income, 17 years of credit history. So robust, strong middle -- upper middle class Americas.

John Hecht
Jefferies LLC, Research Division

Then maybe one quick question on what would it take to increase your conversion rate? And then aside from that, what does it mean to your business, if and when the Fed lowers interest rate?

Gal Krubiner
CEO, Co-Founder & Director

So when you think about that, I think the best way to think about it is we are the regulator that is trying to keep the 2 sides, the funding and the product in balance. And we do that by trimming up and down the conversion in order to meet the return threshold that we believe we need to show to our investors. So as we think about ending the cycle, it's very clear that as we need to maintain a lower kind of asset performance because the cost of capital is going to go down, obviously, it will allow us to open our credit box to increase the conversion. And therefore, to stay with the same infrastructure that we have, but to produce more on a relative basis of the flow that we see.

So as we think about the future, it's definitely an upside to that, but I will say that we need to see the stability coming first. So it's not like that you see 1 month, the rates moving and that you're doing it. You need to see a sustainable place where the U.S. is in a better shape from an interest rate perspective.

John Hecht
Jefferies LLC, Research Division

Okay. And then final question because we're running on the hour here. What are you most excited about the next few years, Gal?

Gal Krubiner
CEO, Co-Founder & Director

So I think that's actually what Sanjiv touched in the beginning. First of all is to work with the people that are here on the call and the hundreds of amazing Pagayans that are doing day and night work to make this mission possible. And I cannot stress enough how much people are putting into that. And as we think about the transformation of the business, to Sanjiv's point in the beginning, there is so much need for a technology partner for these big banks, as they are running through the digitalization, manifest of themselves, and as they think about what they need to be as the digital bank of the next 10 to 20 years. So while we are a big believer in enabling, we want to enable them in all of these pieces. It's very clear that we're doing that today to allow them to have more consumers without balance sheet risk. That's our flagship product. Sanjiv spoke about the new product, which is the second loan and prequalifications. But above and beyond that, there are many more places about modeling that you can share, about different type of technology parts. So there is so much to be said and to be done, helping the U.S. financial system serving consumers the way they should. And I hope and believe that Pagaya could be the biggest partners for all these banks as they're going through this journey. So that's definitely something that I'm most excited about as I look on Pagaya and I look on the next 5 years of our trajectory.

John Hecht
Jefferies LLC, Research Division

All right. Well, thank you very much, you guys. I think we went across a lot of different topics and got a lot of detail and a good update on the business. So we appreciate your time and to all the participants, thanks very much. And maybe we'll have to do this somewhere else down the line.

Gal Krubiner
CEO, Co-Founder & Director

Thanks a lot, John. Appreciate it.

Evangelos Perros
Chief Financial Officer

Thank you very much, John. Thank you, everyone.

Sanjiv Das
President

Thank you, John.

John Hecht
*Jefferies LLC, Research Division*Thank you.