Company Name: Pagaya Technologies Ltd. (PGY)
Event: Canaccord Genuity 43rd Annual Growth Conference
Date: August, 8, 2023

<<Joseph Vafi, Analyst, Canaccord Genuity>>

All right. We're going to keep rolling here at the – at our FinTech and Digital Assets Symposium. Up next, we're pleased to have the man, well, the CFO, Michael Kurlander from Pagaya here with us. Any good FinTech at its core should have a disruptive element to its business model. And Pagaya definitely does leveraging what we believe to be one of the more powerful and holistic next generation credit algos combined with investment vehicles on the other side, raised to fund loan portfolios generated with the credit algo.

That's a really interesting two-sided network starting to generate some good traction. Stock is starting to respond nicely even in this environment. So with that, we're really happy to have Michael Kurlander here with us, CFO of Pagaya. So thanks for being with us here. I try to explain Pagaya a little bit in my own words, but maybe you can jump in and provide us a little more color on the company in your own words.

<<Michael Kurlander, Chief Financial Officer>>

Sure. Thanks, Joe, and thanks for having us. There's a really interesting stat that the CFPB put out last year that something like 42% of U.S. consumers were either denied credit or didn't get the credit that they had asked for from lending institutions. And that that's a real problem. If you add in the people who didn't even ask for credit because they thought they would be rejected, that number goes above 50% of U.S. consumers.

It's a mind boggling statistic. And what our founders stood out to do was solve that problem, solve the problem of consumers not getting credit that they fundamentally deserve and should get. And the way we solve that problem is by using sophisticated data science and technology to work with lending partners to enable those partners to basically generate more lending activity ultimately for consumers.

Business was started about seven years ago, and as you said, Joe, it's a two-sided network. And what we mean by that is, we've developed the technology to help create more credit to the U.S. consumer. But what's really unique about the model is that we don't just go directly to consumers and compete with all the other lending institutions in the world.

We actually partner with those lending institutions, which can be FinTechs to large banks, to enable them to generate more lending activity. That's one side of the network. We call that the partner side. And then on the other side of the network, we take those assets that were created through the Pagaya technology, and we distribute those assets to investors who are looking for a highly diversified, short duration, high yielding fixed income asset. So we're effectively the great connector in the ecosystem by building this network to actually complement and help out both partners and investors.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Great. That's a great intro, Mike. But maybe let's dig into your credit algo a little more. So everyone knows FICO, right? That's kind of what everyone uses as a standard for evaluating credit, but maybe FICO doesn't see everything in the world for a customer and their credit worthiness. So maybe you dig drill down a little bit more into your credit algo and some of the ways you look at the consumer that FICO may miss.

<<Michael Kurlander, Chief Financial Officer>>

Sure. And really the starting point of all this is our core focus. We don't have a customer facing franchise, which means we can spend all of our energy and investment dollars on the data itself and on getting really good at the underwriting equation. And we do that starting with all the publicly available data.

And we have the full history from the credit bureaus that, that others could get as well. But what's really interesting from our standpoint is we combine that data set, that rich data set that we have with all of the application data from over 25 different lending partners. And that's really unique about Pagaya is because of that place in the ecosystem as a network, we can combine publicly available information with application flow that we're seeing. And so that creates an immense data moat of information.

We've evaluated over $1 trillion of credit applications just in our short history of seven years. And having that information is very unique, think of it as all of those different lending partners, we're able to see that flow in addition to the publicly available data. And what you can drive from that using data science is insights that are far more sophisticated than the traditional credit models, as you said, debt to income ratios, FICO scores, we feel like we have a real advantage over those types of models because of the vantage point we have seeing much more of the consumer with the full history of the credit data.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

That's great. And just to be very clear, you're not a lender, you're not taking balance sheet risk yourself, right? You're just – your credit algo is being used by lenders in a partner model, and then they can perhaps approve certain loans that their traditional underwriting would not approve?

<<Michael Kurlander, Chief Financial Officer>>

Exactly. And this is very unique. We help lenders underwrite more loans, but we bring capital to the table. And one of the aspects that's unique about that is the capital that we bring to the table is pre-funded, meaning we're raising investment vehicles with cash first. And that enables us to be very much balance sheet light other than risk retention, which relates to ABS securitization regulations. Other than that aspect, we don't have loans on our balance sheet.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Right.

<<Michael Kurlander, Chief Financial Officer>>

The traditional model of a lender of making a loan, warehousing that loan, and then securitizing or selling that asset, that's not the model that we run. We're starting with cash from investors. And then as those assets are generated, they immediately go into the vehicle keeping our balance sheet lighter and getting the income generation directly in the hands of investors who are looking for that type of exposure.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Right. Let's talk about some of those loan portfolios because you've done a good – a great job on generating demand for your loan portfolios. Who are some of the types of investors that are investing there? And maybe just give us a sigh a little information on the magnitude of how many loan portfolios you've raised over the last few years.

<<Michael Kurlander, Chief Financial Officer>>

Sure. So you want to talk on the lending – lenders or investors?

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Investors, sorry.

<<Michael Kurlander, Chief Financial Officer>>

Investors. Sure.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Investors. Yeah.

<<Michael Kurlander, Chief Financial Officer>>

So we are now the largest issuer of ABS in the…

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Asset-backed securities.

<<Michael Kurlander, Chief Financial Officer>>

Asset-backed securities in the U.S. consumer personal loan space. We've built up a great program led by our capital markets team. We have multiple different types of investment vehicles, ABS being the primary one. We also have privately managed funds. And if you think about the investors, what are they looking for? Investors are looking for access at scale to assets that are highly diversified, short duration, fixed income, higher yielding assets.

And we can generate that again through a 25 different lending partner network, we can create at scale assets for those investors. They tend to be sovereign wealth funds, insurance companies, pension funds, all seeking for something on the short end of their portfolio, diversified from government bonds or corporate credit. This gives them an ability to do that.

Imagine how difficult it would be for them – for those types of institutions to underwrite $10,000 or $20,000 individual personal loans or auto loans. We're giving them the ability to do that in massive size, and we're coming to market every month, every quarter. So we're in a routine source of flow for those investors who've continued to grow with us.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

And just a little bit on the magnitude of size of the portfolios that you've raised over time.

<<Michael Kurlander, Chief Financial Officer>>

Sure. So we're well north of $10 billion as of last quarter. I think we were north of $13 billion just over the last few years of capital raised. As I mentioned, we're the largest issuer in the ABS space for personal loans. And we've been really encouraged even recently, despite a more challenging market by continuing to grow size. In fact, we did a deal a couple weeks ago that was $800 million in size. It was upsized from our original launch. So we're starting to see a lot of demand. Our investor base has grown as more people, I think have seen the product that we can offer and are getting excited about the types of returns that we can help generate.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Great. And then on those returns, I know, I mean, I know you're reporting this week, we're not going to dig into that too much, but historically, over time, your loan portfolios have outperformed the benchmarks at least on certain metrics, right?

<<Michael Kurlander, Chief Financial Officer>>

Sure. In the unsecured loan space, the auto loan space, there will always be delinquencies, that is a part of the market. And that's why rates are in the high teens on the loans themselves. But what we've been able to do through that vantage point, we have, again, of the – all of the available data with the – from the credit bureaus plus the partner level application flow, we feel like we've really been able to build a model that drives relative outperformance. So when we compare ourselves to the benchmarks, we've been consistently lower, if you think about it either just on a delinquencies basis or on a net-net being the income from the actual asset, less delinquencies, we've been able to continuously be better than the market benchmarks. And we feel like that's really driven by one, again, the sole focus on this is our main mission, and two, the data that we have through the network that is really unique to Pagaya.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

That's great. That's great. Maybe just kind of switch gears, talk about the macro environment a little bit. It's clearly has been uncertain, still uncertain, you're dealing with certain stripe of consumer credit that is affected by the macro. And how are you looking at that as both an opportunity and a risk?

<<Michael Kurlander, Chief Financial Officer>>

Sure. So obviously higher cost of capital is not a great thing. It's something that we've had to take into account into our lending models. So as interest rates arose, we have a higher hurdle rate and that means that we have to be careful to make sure we're continuing to generate the returns our investors are seeking. So that's a headwind for sure for I think all market participants. But within that, we see a lot of positive green shoots.

One, the consumer's been relatively healthy. And if you look at things like unemployment rates, which is a big predictor of consumer performance, that's incredibly strong and continues to remain at historical low levels. And when you think about even some of the macro pressures on the banking sector. The product that Pagaya offers actually is a solution for banks who are thinking and maybe having to deal with higher regulatory capital requirements in the future. We're a solution to enable banks to continue to grow their business without having the balance sheet and the risk on their own balance sheet. So from that angle, we're actually really optimistic and excited about the current set of circumstances and how that bodes well for Pagaya's growth in the future.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

That's great. Maybe we talk about those lending partners a little bit more. It's a pretty nice list of a lot of brand names. Maybe you could throw out a couple of your brand names. And then also some of these lending partners, you're really reaching material volume levels with them. They are really using your model a lot. So maybe you could talk about what you've disclosed in the past of – some of those lending partners and what kind of percent of volume is being generated via Pagaya.

<<Michael Kurlander, Chief Financial Officer>>

Sure. It's a really interesting story. When the business was first formed in 2016, really the first set of partners that we penetrated were the fintechs. These were the companies that really started post-financial crisis that were aimed to disrupt the old banking system. And they were newer technology driven companies like a SoFi or Avant or Marlette or an upgrade and they were happy to partner with us, because we actually helped enable and grow their businesses as they formed. What we found is we got a couple years in and we largely penetrated a large portion of those types of lenders, is that actually this product is equally, if not as even better for the large banks. And so we really started investing very heavily to go after banks that have obviously much higher volumes.

Those banks that are concerned about losing business to those new upstarts of the world, we could actually help them maintain their business by employing Pagaya's product, again, to generate more of activity, not lose the business, and actually not have to hold the balance sheet that they had historically done. And so very recently, we've been pleased as we've expanded out to announce one very large U.S. bank, it's ally on the auto side. We've also partnered with Klarna growing their buy now pay later business.

And so we've extended our product set out personal loans, auto, point of sale, or buy now pay later, credit cards and single family rental in the real estate world. So we have a very diverse product set, and that's enabled us to really grow our partner base and we're really excited about the opportunity set in the future now that we're – we've invested very heavily to handle and partner with some of the largest banks in the U.S. We're excited about what that brings from a total addressable market standpoint into the future of Pagaya.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

That's great. And then how do you feel about that new logo cadence here in this macro? You mentioned like, the big banks and losing business to fintechs, and what's the appetite and what's the kind of – what's the dialogue going on with potential new lending partners?

<<Michael Kurlander, Chief Financial Officer>>

Very strong dialogue. The top 20 banks in the U.S. do north of $600 billion of lending volume every year. So it's a massive market and we're deep in discussions with many of them, because again, the product that we're offering is very complimentary to what they're doing. And so it's a very easy early conversation of, would you like to generate more lending volume, do it without the balance sheet and the capital requirements. Typically that's [indiscernible] (0:14:42) very positively. I will say dealing with large banks in the U.S. that's a very long onboarding period.

Typically, it can be nine months to over a year with a large bank. And so it's not the cadence where every quarter we're expecting that there's four new banks under the wing, but we're very active in conversations with many of them right now. And so if we can generate even just a few of those large banks in the next year or two, it means very well I think for the potential for us to ramp our network volume.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Right. And I think just going back to some of those partners, you're a material portion of their volumes now, right? And that we'll get into your financial model in a little bit, but I think that provides you an extra margin opportunity kind of in a rev share model.

<<Michael Kurlander, Chief Financial Officer>>

Absolutely. When we first started, we were very clear to go out and not really fight for every dollar economics. We wanted to prove ourselves. We wanted to prove to the partners that our model could really be successful for them. And as you point out, we've now with our largest partners, we can be north of 15% to 20% of their volume. So we're incredibly material for their business. And as that becomes more and more entrenched, that gives us an ability to then have that conversation and talk about the economics to make sure that's everyone's winning in this situation. And the partners are continuing to grow, Pagaya's earning a bit of the revenue share of those – of that growth. And we feel like we're in a position now where a lot of that can actually take hold and that's driven some of our recent success from a profitability standpoint.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

That's great. Switch back maybe to the macro a little bit on a specific question, and that is the way your model works is you – all of this loan application information comes in, your algo looks at it and basically says yes or no to the loan very quickly, right?

<<Michael Kurlander, Chief Financial Officer>>

The entire platform is 100% automated. This is – the network is getting pinged at the same time, the lender is getting pinged with the application. So this is all happening within milliseconds. In fact, one of our lending partners using Pagaya, the actual consumer doesn't even know that Pagaya is involved. It's an immediate response from that lending institution. Think of it as just being powered by Pagaya, but it's a 100% real time fully automated.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Right. But against that backdrop, which is – so you can dial up or down the approval rates, right. And I think you've dialed them down recently, which I personally like, I want to see these loan portfolios perform well in the current macro and ensure that the model is always successful. And so you've dialed down that approval rate recently relative to adding a little bit extra prudence to the underwriting model. Is that right? Yeah.

<<Michael Kurlander, Chief Financial Officer>>

Exactly. That's exactly right. At the end of the day, we need to perform for our investors, our investors who are continuing to come to us to deploy capital. We need to generate returns for those investors. That's our core mission. And as we think about that, so as rates have risen, that means that with all of the application flow that we see, we are proactively tightening the credit box ourselves. That means lower conversion on a higher set of applications. That means we are not growing as fast as we otherwise could. But we're doing that, as you said, prudently because we want to make sure we are generating the right returns for our investors. That does give a lot of forward potential for growth because when the macro improves whenever that may be with the application flow that we see changing that conversion ratio and increasing it could lead to significant potential for future volume on the same application flow. But we're not doing that right now because we're being very selective to make sure that the investor returns are being met.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

That's great. And the demand has been there and the loan vehicles are oversubscribed. So I think that is…

<<Michael Kurlander, Chief Financial Officer>>

Exactly.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

That is the right strategy so…

<<Michael Kurlander, Chief Financial Officer>>

For us to be able to operate the two-sided network, it's important that we've got the application flow on one side, and then we also have the lender demand on the other side. And so we're very focused on making sure we maintain that so that the network can grow.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

That's right. Maybe we switch a little bit to your financial model, which I think should have some good operating leverage in it over time. But you're now EBITDA positive where you were last quarter.

<<Michael Kurlander, Chief Financial Officer>>

Yes. We were in the first quarter. That's right. We're releasing results in two days. And so, we'll keep comments to the first quarter at least for now. But we did turn EBITDA positive. Now, historically we had been EBITDA positive as well. I mentioned investing heavily. Last year, we invested in all of the infrastructure to be able to work with the largest banks in the U.S. And – but now we've returned back to EBITDA positive in the first quarter. And we're excited about what that does for us and how we think about that in the future.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Sure. That's great. And then the interesting thing about your algo is that it can be plugged in pretty quickly into not just lending partners, but you can also, you've been able to successfully move to other loan classes, right, personal loans, auto, I guess credit card portfolios, right?

<<Michael Kurlander, Chief Financial Officer>>

Correct.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

And then renting, right, as well.

<<Michael Kurlander, Chief Financial Officer>>

Yes. Real estate is a newer product for us, but it's a five products set.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Right. And so, and you've done a little M&A, right, I know recently. Especially in that – in the rent – renting market. Do you see some other interesting kind of loan – buckets of loan volume out there that may be ripe for M&A or additions to the model?

<<Michael Kurlander, Chief Financial Officer>>

We do. If you think about the Pagaya model with all the data that we have, we feel like we have an advantage in pricing consumer assets. Anywhere where there's a decision being made that involves consumer credit, we feel like we have an opportunity to participate. And so we're in five markets today, as you mentioned. But there's others that exist out there. If you think about every, the consumer lifecycle, all the different points during the day that consumers are evaluated for credit in different products.

We definitely feel like there's other opportunities from an M&A perspective, either to expand out the product set or within one product that we're operating in where we can more vertically integrate. And that was the example of the one M&A that we did earlier this year, which was Darwin Homes that operates in the real estate space. They use technology to help manage properties. We have a SFR business. And so that was a very nice complement to be actually be able to complete more of the vertical insourcing of that full stack under our umbrella. So that's what really I think interests us is either, again, the ability to expand out our product set even further, where we've been able to demonstrate growth from one to five products over a very short period of time, or either vertically integrated in one of the products where we're outsourcing some pieces of that right now.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Great. I know you went into auto not too long ago. How long ago did you go into auto?

<<Michael Kurlander, Chief Financial Officer>>

It was 2019, I believe so.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Okay, 2019. And now it's a big piece of the business, right, so…

<<Michael Kurlander, Chief Financial Officer>>

It is. We're really excited about that, yes.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Okay. And maybe we just dig into the auto lending opportunity a little bit more.

<<Michael Kurlander, Chief Financial Officer>>

Sure. So this is I think a really good example of how the business models enabled us to scale very quickly. Think about how distributed the auto lending world is in the U.S., thousands of dealerships across every state in the U.S. Through our product, we've been able to partner with some of the leading lending institutions in the U.S. Ally being the latest one. And just through that integration itself, we're now in over 20,000 franchise dealerships across the U.S. That would've taken decades to go door to door, knocking on doors to offer the Pagaya product to each one of those different dealerships.

But through the partnerships that we've had, we've now been able to grow very significantly in over a short period of time where now given that the partners already entrenched into all of those dealerships, it's one integration on our side into the lending partner. And then that gives us exposure and asset into many, many, many different storefronts, let's call it in the U.S. Obviously, that market is massive. The securitization market is also massive for that product. And so we feel like that's a really good place for us to grow because you've got both sides of the network that can use a product like Pagaya.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

That's great. And then I think that just underscores your model is a B2B2C model, which I think is really compelling, right? You sell to a lender or you partner with a lender, they're not really, you're – they're your partners. And then they have big distribution themselves, right?

<<Michael Kurlander, Chief Financial Officer>>

Exactly. Exactly.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

So you focus on a few lenders and then you get leverage out into their customers.

<<Michael Kurlander, Chief Financial Officer>>

It allows us to really focus on our core mission, which is the technology and the data. And our partners are doing the hard work of being the storefront to generate consumers. It works very, very well. And the key part and this is what's really enabled us to grow as fast as we've grown. We did over $7 billion of total network volume last year. What's enabled us to grow so much is the fact that we're complementary. We're not competing with those lenders. We're actually helping them grow their business. And so that win-win type of model has allowed us to scale very rapidly.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

That's great. We'll see just any other comments you got for us here? Are there anything that we missed, Michael, that we should be like focused on here?

<<Michael Kurlander, Chief Financial Officer>>

I think you covered everything. I think, for us the ability to operate across five different product segments gives us a really good diversification that allows us to operate through the cycles. And I think the number one takeaway for this audience is that because of the B2B2C business model and the fact that we've got a two-sided network, it's really allowed us to continuously operate and grow in both the liquid macroeconomic environments as well as the more challenging macroeconomic environments. And that's I think a key thing that we stress to people who are just getting to know Pagaya, is we feel like we can produce consistent results because of that two-sided network.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Great. We're out of time, Michael. So Michael, Pagaya – Michael Kurlander from Pagaya. Thanks.

<<Michael Kurlander, Chief Financial Officer>>

Sometimes I call myself.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Yes. Yes.

<<Michael Kurlander, Chief Financial Officer>>

Thank you very much.

<<Joseph Vafi, Analyst, Canaccord Genuity>>

Thanks very much.

<<Michael Kurlander, Chief Financial Officer>>

Thank you.