LEND ACADEMY

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Peter Renton: Today on the show, I am delighted to welcome Rory Eakin, he is the Co-Founder and COO of CircleUp. CircleUp are an online marketplace, they are focused on equity investing, although we'll get to another product offering in this show, they're focused on one category, the consumer goods category, and they have built up a business with tremendous knowledge, tremendous data on this category.

It's very impressive to me what they've done as far as accessing data based on this one category, we talk quite a lot about that. We talk about how they do due diligence and how they're using this data to underwrite these companies and we also talk about their debt offering which they began...they now offer loans, a product they launched earlier in 2017 so we talk about that in some depth as well. It was a fascinating interview. I hope you enjoy the show!

Welcome to the podcast, Rory.

Rory Eakin: Glad to be here.

Peter: Okay, so let's get started and give the listeners a little bit of background about yourself, tell us what you did before you started CircleUp.

Rory: Sure, I have a somewhat circuitous route to this work. After college, I actually went to Cape Town, South Africa for several years and taught a math class at the University of Cape Town. It was an interesting and early formative experience in my career for several years before coming out to California for my MBA and a couple of years at Boston Consulting Group before having an investing role with a family office entity of Pam and Pierre Omidyar.

So the founder of eBay, Pierre Omidyar and his wife set up a number of different entities and for about four years my role was investing in marketplaces, in market driven mechanisms that were seeking to improve the world. They were really focused at the time around thinking about ways technology could make the world a better place. It was the early days of the concept of impact investing so thinking about social impact and benefits for society as well as investment returns. It was a fascinating and challenging role that really opened my eyes to the power of technology to improve outcomes around the world and create more efficiency.

So I was doing that globally for about four years when my co-founder, Ryan and I started thinking about the idea here in the US and applying technology to a big part of the US economy that just wasn't working as efficiently as possible.

Peter: Right, right, well that makes more sense so I think I can confidently say you're the first person that I've had here on the podcast who was a teacher in South Africa (laughs). So that is a circuitous route, I mean the Omidyar, that's obviously not that unusual, but boy, what led you to go down there?

Rory: It was a fascinating fork. You think back to your career and the different moments over time, but I was graduating from university at the time and had done an internship in investment banking and had an offer to return to that path and sort of go a more traditional route of a couple of years in investment banking and then thinking MBA graduate school after that and there's this fellowship opportunity, a program through my college that gave us a chance to teach in the classroom in Cape Town. It was something I couldn't miss, I thought it was a good opportunity to broaden my horizon and challenge myself in a new way.

Peter: Sure.

Rory: And I still look back at those days as a time that I really grew and challenged…the skill sets I pull on from that I think served me better than an analyst program at an investment bank, at this point in the career.

Peter: Right, right, makes sense, makes sense. So anyway, let's move forward to CircleUp. You guys have been around for quite a long time, what was the impetus behind doing this? What problem were you trying to solve?

Rory: It was the intersection of our two backgrounds, my co-founder Ryan Caldbeck and I. I was coming out of that world thinking about applying technology to large markets and the ways you can move industries and problem sets from analog to digital. Ryan had spent his career in middle market private equity focused on the consumer goods sector in the US so packaged goods products, food, beverage, personal care and with seeing a massive secular shift in small brands taking share from big brands. When we were looking across the economy, this was now 2012, seeing so many small companies growing so quickly, but no system of support for those businesses unlike technology, there's no Silicon Valley.

You had companies spread all across the country who were looking for capital and no pathway for them to raise capital. And so it was a tie in between those two backgrounds where a marketplace at that time came to us as a potential solution, we were looking for something that would apply technology to improve the lives of entrepreneurs and investors. You use technology to lower the costs on both sides. You have to find the right partner, whether from an investor to a company or a company to investor, and to do it in an information rich and data rich environment. You can get much more efficient for both pathways.

Peter: So did you sort of go out with the intention of tackling the consumer goods category or did this sort of evolve over time?

Rory: That was from day one. Much to the consternation of a lot of the investors we were talking to at the time. As we looked to raise capital, everyone was saying why not tech. You know, there was such a focus on early stage tech investing, especially out here in Silicon Valley. We were in San Francisco at the time and in my view very myopic view that the only place for early stage investing was tech. I think that's changed dramatically in the last five years in part because of CircleUp, but from a wider recognition of how much these other industries can see great growth from early stage companies.

But we saw a massive industry in consumer and a problem to be solved even then and still today. There's so much capital looking for early stage companies and there's so much of a tech echo chamber for small businesses, for tech companies to find those investors and for investors to find. I didn't see as much of a pain point and as much of a big opportunity to solve and, of course, later and I think something to talk about, consumer lent itself very well because of the data availability in consumer. It's enabled us to do things that I don't think would be possible in the tech industry, but consumer was the focus from day one.

Peter: Right, that's interesting because...you know, it's funny because in a previous life I actually ran a digital label printing company and most of my customers were in the consumer goods category. It's a category that I got to know well and it's funny because I know raising capital was perennially challenging for these companies. We would actually be somewhat of a quasi capital provider by extending out our terms for 90 or 120 days because they had a cash crunch. There wasn't a company like CircleUp back then and this is in the early 2000s and it's been a perennial challenge, I think. So can you just give us then some examples of companies that have successfully raised capital on CircleUp?

Rory: Sure, we work across the consumer spectrum; food & beverage, personal care, pet, baby so some companies that have worked with us include Halo Top Ice Cream, it was a very small brand at the time. It's now the number one pint seller in the US in the ice cream category. It has done very well, a type of innovative brand that put a different lens on the ice cream category back four years ago and found support on the platform to grow that.

Back to the Roots, which is another food company that's done very well and incorporates social mission; Smarty Pants Vitamins in the vitamin category, a company that creates a gummy vitamin, has some intellectual property and a really compelling brand around that so these are the types of brands we see. Companies typically with $1 to $10 million in revenue, they have some traction in the marketplace, but they're looking to accelerate that growth.

Peter: Obviously you've got a range of different companies inside the consumer goods category and I imagine you've got a pretty efficient due diligence process because I imagine people come to you and you see...oh my goodness, there's no way we're lending money to that company and there are others that it's touch and go. What's your filtering process and how do you go about deciding whether a company is worthy of your platform?

Rory: So it's been an evolving process like any business. What was initially, in the early days, more manual, we had a team of experienced private equity investors and investment bankers that were looking at companies on a one-off basis and evaluating them based on their own training…had a committee and a process to approve that, typical diligence at the time. So you talk with the management team, you look through the financials and the projections. From day one we've been a registered broker/dealer so we also have compliance and suitability requirements that we conform to and as well to make sure we understand the offering and the background of the team and make sure it's suitable for the investors on our platform. We work only with accredited investors so there are certain standards that we have to conform to there as well, but what's been really powerful over time is using data and machine learning to try and make that process more efficient.

We've built some core technology that we overall brand Helio, a set of internal data and algorithms that are helping us look not only at the applications when they come in but across the entire consumer sector on a regular basis evaluating brands even before they apply to CircleUp around a number of dimensions that we believe are powerful predictors of future success. And that's really the starting point for us today and it allows us to be, we believe, a lot more scalable, a lot more accurate over time in working with the types of businesses that we believe have the potential to outperform.

Peter: Do you still do human review or do you rely on your...

Rory: We do.

Peter: You do, okay, so is the machine learning like a first cut, is it?

Rory: It's both a first cut and something that we work on throughout the process so it's not just a filtering mechanism at the top of the funnel but something that our business teams are engaged with throughout the process.

Peter: Okay, okay, that makes sense. We chatted a year or two ago, I remember you said at the time that you were also tracking all of the companies that you reject for funding, I mean, so what have you learned there? Have you incorporated that information into your due diligence?

Rory: We have and that's become one of the powerful sources of that data. It's expanded even beyond that now where it's not just the companies that are applying to us but a foundational leap for us was making the move from beyond just the companies that we were looking at but to map the broader industry. So we are today tracking over 1.2 million companies in the consumer sector and maybe just to take a step back and reflect on that.

An amazing part about the consumer industry relative to other categories is the availability of information about the brands. If you want to you can look up any company in the US which you know the name of the company, and find out a whole host of information about them; where they're sold, what the price point is, what SKUs are available, what customers think of those products. All of that information is publicly available, but aggregating all of that and making sense of it and normalizing it. So you're looking across different information sources and tying it back to a single company and then having that core data from our marketplace over time of what's successful and what's not and that goes to your question around the application data, that gives us the ability to perhaps ground truth training data.

So we take our training data about the companies and how they're performing from our marketplace but are now applying it not only to the companies that apply or have applied and are rejected that we're able to track on an ongoing basis, but to the universe of companies at large. That becomes a much more powerful tool for us in evaluating any given brand. Because like any investor, the challenge you have is not only yes or no to a given company, but ideally, how does this company situate within its universe.

If you're evaluating a popcorn company, you don't want to only make that decision, do I want to work with this popcorn company or not. You want to say well...kind of look across the 800 popcorn companies that are available in North America and which one of those would I want to work with and then be more proactive in your outreach, not passive and see what company you'd want to partner with.

Peter: That's fascinating, fascinating. Are you working with vendors, is this something you've built yourself because I imagine just going out and scouring the web with all of this information, it's not a trivial engineering task. (Rory laughs) Have you built this in-house or are you using outside vendors?

Rory: It is all internal. This is a core IP part of what we've done and I think it's a very big part of the CircleUp story. As you noted, we've been around five years, we've been very successful from a fundraising perspective to be able to raise a significant amount of capital to build a wonderful team that is highly talented and have built this core product all internally.

Peter: Wow, that's impressive. So the companies that typically get funded, these are not really...I mean, there's not many venture-backable companies I imagine in this space. What is the size of the round that they are typically doing and is this really a seed round, are they looking at this for working capital? Can you just tell us a bit about the fundraising that the companies are doing?

Rory: Sure, on the equity side, and that's where the marketplace has been over the last five years traditionally, it's growth equity so typically $1 to $5 million rounds. You say not traditional venture-backed, but we see a lot of private equity firms, lower middle market private equity firms and family offices active in this space. So the typical transaction for us is a family office, perhaps outside of that geography or somebody that wouldn't otherwise be connected to this brand who meets the company through our process and conducts their own due diligence, of course, in addition to information presented through the platform and then ultimately writes a check on their side anywhere from $250 thousand to $2 million.

So the overall rounds are $1 to $5 million and you have a small number of investors typically, but that gives us the information about the brand themselves. The companies we typically work with already have about $1 million in revenue allowing us to do that work I was alluding to from the data science side about their performance and how they compare to others in the category.

Peter: Right, okay, so then given that you've been around for a while and I imagine there's been some exits...you know, I see deals all of the time of food companies being bought it seems and other consumer goods companies by some of the big players in this space who are looking for these niche brands, so can you tell us a little bit about the numbers like how many deals you've done, how many exits, how many failures actually would be useful as well.

Rory: So the first cut is we don't have perfect information on the companies as the marketplace we connect to investors, but we don't typically become shareholders in the businesses themselves so I'll update where we are today, but with all of our businesses we aren't able to understand future financings with full clarity and exits around that.

But 250 companies have raised on the platform and from what we see and the visibility we have, we're quite pleased with the aggregate results. It is still a high risk illiquid asset class so no exits yet, but the companies that have grown…we have a number of companies that have grown quite substantially. So we know of at least ten companies that are no longer operating out of those 250 so it's a very small percentage.

Today, there are likely to be more already and more in the future, it remains a high risk illiquid asset class for us, but in aggregate, we believe the investors in our portfolio overall across the marketplace will do well over time.

Peter: So you said you're tracking these companies. You can obviously track to some extent their growth.

Rory: Yes.

Peter: Do you have some stats on how the companies that you funded are growing, particularly like versus the average in the space, that would be interesting.

Rory: Yes, that's one thing we have been able to do. The companies that raised versus not and the last time we looked through that data there was significant outperforms, in part because they raised capital successfully. So when you have additional capital, you're able to grow, but the aggregate revenue CAGR (Compound Annual Growth Rate) for companies on the platform was over 30%, meaning they were growing their revenue from the time that they had raised on the platform more than 30% per year annually through to today.

So we are still building out our full information set on the financings and potential exits, revenue being one of the key drivers of growth which gives us the understanding that the companies themselves are growing quite nicely as a portfolio overall. There's still variability, of course, in that, you know, the companies that grow a 100X in some extreme cases in revenue from the time that they've raised capital to companies that aren't performing as well. But across that portfolio you have a 30% average annual revenue growth which we think is quite where we want to be.

Peter: And so what about the investors that are investing on your platform, are these typically just high net worth individuals? Are you working with some institutional funds now as well, who is investing?

Rory: We have a mix of both like I know a number of the marketplace lenders do as well. The average investment on the platform now is about $200,000 so it's more oriented towards family offices and what you'd call quasi institutional investors. We do have a series of funds that we have raised as well so there's the marketplace where there's individual security selection. An investor can come identify a company and make a direct investment into a company and then our funds where investors can get diversification through a fund that we manage. An example of that is a $22 million fund that has institutional investors looking for allocation to the asset class overall that we help build a portfolio that's diversified within the companies that are raising on the marketplace.

Peter: Okay, I want to switch gears a little bit and talk about your debt product that you launched earlier this year. Is this something that was driven by the consumer companies or is this something that you just felt like was a natural extension?

Rory: (laughs) No it was what we were seeing day to day. There are so many companies who are struggling with the credit options in the market and both us not having the ability to work with them on an equity side given what we were seeing as a potential forecast, there is just so much you need to believe for a business to underwrite it for equity in terms of the future state versus on a credit which is a much shorter term financial product and one that's backed by actually credit versus equity as well. We were seeing companies facing that cash crunch that you alluded to earlier, you know, retailers paying 30/60/90 days after they get the product and the irony was the faster the companies were growing, the bigger the challenge they have.

Peter: Right.

Rory: As next month's shipment gets bigger and bigger, if customers are loving the product they face greater cash needs and as an entrepreneur you're faced with either raising a big equity round and taking that dilution at today's valuation...we're trying to build a couple of more of those cycles where you're able to have better performance numbers and take on less equity potentially or at least equity at a higher valuation.

So we tailored the product towards this market where it's a working capital credit line, we're trying to fill that void in the market today, relatively more affordable rates and clean terms, in our view, and disclose when we talk through that with customers, but help them when their product is moving on the shelf build more product and increase the velocity of that growth without having to take on the equity dilution.

Peter: Right, right, that's what I used to see when I ran my label printing company. We'd have these companies that were selling into Whole Foods or some other pretty established company and that's when you feel like it's a pretty good bet that they're going to pay, but they still needed the capital. I know it's a perennial problem so what terms then are you offering? What's the typical loan size, the duration, the interest rate, what are the averages there?

Rory: So the target company is roughly the same so these are companies with $1 to 10 million revenue, they're typically EBITDA negative and that's where we saw there wasn't a lot of great options for the companies in the market. Others in the space either would be very high interest rates on a merchant cash advance basis or a decline from a term loan or some of the other bigger loan products. So we built our product that provide ranges of $25 to $750k, so the average loan for us today is about $150 to $200k; the interest rates are 6 to 15%, but all in APR is in the 14 to 20%. We feel that the product is quite competitively priced given the profile of the businesses and we're trying to move that down further over time. It's something that…

Peter: So are these secured loans because one of the things that's different about these kinds of companies is that they actually have hard assets. I mean, are you backing these loans with assets or receivables or something like that?

Rory: Yeah, it started with receivables. We're underwriting to receivables and purchase orders, and so it's backed by the assets. There's a UCC-1 lien position.

Peter: Right, right. Okay, so then I read when I saw your announcement that it was CIM, Community Investment Management, a company that we know very well. We've had Jacob Haar on the podcast here.

Rory: I saw, it was one of my ways to get to know Jacob was through your podcast Peter.

Peter: (laughs) Oh, that's good to hear. So they're funding, I believe, all the initial loans, but are you intending to opening this up for other investors like for your existing equity investors that are on your platform?

Rory: Potentially over time, we're still in the pilot phase now. This is an early program for us and CIM have been terrific in terms of helping us structure the loan and providing sufficient capital to get this business off the ground. Over time, it's an interesting product for us because it provides a much shorter duration. When you think back to the questions we were talking about in the marketplace business, we are five years in without clean exits on the equity side despite what we think is tremendous progress in understanding this consumer market and markers indicating what could be long term future success of the equity investments that have already been made and will continue to be made.

But having this loan product allowing for a much quicker cash cycle for our own investors is something that we're going to explore over time, but for now, CIM has been terrific and we're focused on getting the product right. We're in that phase where there's a lot of more iterations in terms of talking to our customers about this product and how we're structuring it so it's not quite ready yet to broaden the investor side of that equation.

Peter: So are you out there marketing this product actively or you just sort of passively marketing it to people who come to you?

Rory: (laughs) A bit in between, it's companies that are coming on the marketplace. It's not fully on the website yet, but we've certainly announced the product and have early companies that are active with us, that have been in the marketplace before or that we knew quite well and it's fully expanded beyond that. So we have just passed about 100 loans, it's still relatively early.

Peter: Right, right, so do you see this...obviously in the marketplace lending space there's plenty of competition. You've got Funding Circle, also another Bay Area company that are offering it, Lending Club are offering it. There's many, many other competitors. Are you seeing this as....are you trying to build this up and compete against those guys or is this something that really...you feel like because you're vertically focused on the consumer goods category that you're going to stay there?

Rory: That's right, it's the vertical focus for the why this makes sense. You know, I was in conceiving in developing this product with the team, hyper-aware of that market and there's some fantastic companies out there that have built great businesses in the small business lending space, online and offline. You always have to ask yourself, why us and where's this need, but as we look through the data and talk to our customers, we do not see anybody out there that was offering a similar product to be able to have a couple of hundred thousand dollars on a loan product that didn't have a usurious interest rate on the product. It could work with you as you are growing your business, grow alongside your business, but before you were profitable, before you perhaps had been operating for two/three/four years where a lot of the traditional lenders would look for that history in an operating business.

Peter: Right.

Rory: We saw and we continue to see a very big market within that target demographic and using our data analytics from Helio, being able to both serve those customers more efficiently and improve our underwriting process, we think lends itself well to a business that we're uniquely suited to develop.

Peter: Yeah, that makes sense because most lenders or many, many lenders anyway, they get nervous about lending to companies with negative EBITDA so I can see that if you've got all of this data on the companies then you have a big advantage there because you can see what the real risk is where some of the other companies don't or won't have the same sort of data that you guys have. So we're almost out of time, but I just wanted to give the listeners a little bit of an idea about where you're taking this company. Are you just going to grow your two kind of products that you've got now or what does the future hold for CircleUp?

Rory: Data as a tool, we think a lot about our central mission which hasn't changed is helping entrepreneurs thrive so how can we orient towards providing financial products and resources to help those businesses that may have historically been overlooked or underserved by financial markets. That's really the core of what we're doing and Helio is a pathway to do that at lower cost. We have an internal framework here that is not actually ours, it came from a piece of Gartner Research that I just love though. It talks about how you can move up a learning curve by utilizing data so if you think about the descriptive qualities of data you can tell a story about what happened as a first stage and there are a number of data partners that say X company sold Y units last year and that's a very descriptive use of data, but the next phase being a diagnostic, well why did it happen?

You know, if a company went from $2 million revenue to $4 million in revenue, is there something you could say about explaining that difference over time. It's more technically challenging, you need better data and better insights to do that. A third phase would then be well what will happen? That's where we think we are in Helio today, is seeking to answer that question, it’s $4 million today, what will next year look like? Are there pathways we can see to how their receivables will grow, for example, in the case of the credit product or their top line revenue will grow? Can we map out different pathways their distribution might increase based on looking at enough comparable companies across the sector where we can predict what's going to go.

And then, ultimately, and this is where we want to go with the company is, how can we help make it happen for the entrepreneurs, how can we be partners to these businesses and provide at scale, quantitatively supported advice and support to these brands. So when you raise capital from CircleUp, whether it's on the debt or equity side, you're also bringing on a partner that has an unparalleled data resource that can help you be successful. So when you’re going to that new retailer or distributor, you are armed with a pack of information describing how your brand is differentiated in the market or if you're thinking about a new product line, new SKU development, you've got a thought partner that has a rich data set that can answer fundamental questions about when, and how and why you might want to introduce that category.

We think those are questions that can be answered in part through data and building out Helio is a pathway to provide that more and more value to the entrepreneurs through these products. That's the journey we're on.

Peter: Right, that's fascinating. My mind was ticking when you were talking about that. There's just so many possibilities there and the value that some of these companies would take I think...just basically the data that you have is going to be so valuable I see even today I imagine it's just going to keep getting better. Anyway, we'll have to leave it there. I really appreciate you coming on the show today, Rory.

Rory: Thanks so much, Peter, appreciate it.

Peter: Okay, see you.

One of the things I love about this industry, the fintech industry broadly, is this use of data that many companies are out there doing things that have never been done before, gathering in data sources that have never been used before and sort of compiling all of this in such a way to give a much clearer picture of a particular company or an individual. The stuff that CircleUp are doing around data is truly fascinating and they're building themselves a very wide moat in their business because this use of data, this creation of not just the analysis tools, but the sort of data gathering is not a trivial task, it’s something that any company, big or small, would find difficult to duplicate. So I think what CircleUp are doing there is going to position them very well for the future in providing their core category with additional value.

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

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