LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 248-JON BARLOW

Welcome to the Lend Academy Podcast, Episode No. 248, this is your host, Peter Renton, Founder of Lend Academy and Co-Founder of the LendIt Fintech Conference.

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Peter Renton: Today on the show, I am delighted to welcome back Jon Barlow, he is the CEO and Founder of Finitive. Now, many people would know him as the CEO and Founder of Eaglewood Capital, a company he sold several years ago. They were a real pioneer in the online lending space, but his new venture was not that new anymore, it's two and a half years old, but his new venture is all about connecting institutional investors of which he was one, obviously, with non-bank lenders and so, he's done this.

He's the first one to really bring a sophisticated intermediary tech-enabled platform to make it much easier for the platforms to raise money and make it much easier for institutional investors to deploy capital. Now, we go into some detail about how all these works and we talk about the impact of COVID-19 on his operations and on the non-bank lending sector, in general. He talks about the scale they're at and gives his thoughts on what the future might hold for the non-bank lending sector. It was a fascinating interview, I hope you enjoy the show.

Welcome back to the podcast, Jon!

Jon Barlow: Thanks, Peter and it's always great to speak with you.

Peter: Likewise. So, it's been quite a few years since we last chatted here on the podcast and you were still at Eaglewood at that stage. Maybe you can just give the listeners a little bit of an update about what you've been doing since you left Eaglewood.

Jon: Sure. So, I sold Eaglewood in the summer of 2015, and after that I was an angel investor and was mostly providing early stage capital back into the fintech sector. I ended up joining eight fintech boards and all of the companies were either lending companies, or technology providers to lending companies.

A majority of the work that I did during that time centered around helping these companies build and improve their capital markets programs. I really enjoyed the time actually, I found it's a lot easier to tell other people, you know, how to run their business than it is to actually run a business. So, I had a great time doing that, but eventually, I got a little bored watching the game from the sidelines and so, I decided to start my new company, Finitive.

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Peter: Okay. So, what was sort of the impetus there, I mean, apart from being bored, what were you really trying to accomplish?

Jon: Just given my background, I'm very well acquainted with pain points and challenges that institutional investors and non-bank lenders alike face in closing credit facilities, institutional credit transactions and I just saw a systematic need for yield from the investment community and a systematic need for capital from the non-bank lending community. And yet, both sides were complaining that they weren't getting enough transactions done and the problem, in my view, is really transaction costs.

It's expensive closing transactions in this sector, certainly, in terms of money, but even more so when you consider the time involved, and I think time is actually the biggest transaction cost. These non-bank lenders and the investors who fund them have them in our standing converts, or even thousands of man hours from start to finish closing a single transaction and I don't think it should take that long so I started Finitive to solve this problem.

Peter: Okay. Then why don't you take us through how your platform works exactly and how you've been able to sort of take some of the time and costs of these still complex transactions?

Jon: Sure. So, our goal is to make institutional credit transactions fast and easy, similar to what the online lenders that we've covered for many years have done for consumers and small businesses over the past decade. I think the same can happen in a B2B, or an institutional context, and so, we've built a marketplace, Finitive, for institutional credit facilities in the non-bank lending sector. Our platform is free for investors, all of the investors who are on our platform are institutional, you have to have, at least, $50 Million of assets under management to get onto the platform.

Most of the investors are credit bonds, banks, insurance companies and we've got a number of other investor types as well. Through the platform, these investors can access highly, that is, data rooms provided by originators who are our clients. We are hired by originators, not by investors and we've got teams of people who vet and diligence each of these transactions from a, what we call, a buy-side perspectives so, we've got teams of people who use the institutional investors, used to be us, to stay on the buy-side and they build models, they build data rooms, they write investment committee memos, typically 50 to 100 pages in length and replicate what institutional investors are doing internally.

All of that information is easily accessed and downloadable in a very rapid manner by the institutional investor community so, our investors save a tremendous amount of time finding opportunities and then gathering the data that they need to perform due diligence on those opportunities. And so, we tell a lot of our non-bank lending prospective clients that by the time an investor starts talking to them, they will already be fairly well advanced through the due diligence process and it saves both sides a tremendous amount of time.

There's some similarities between our platform and a crowdfunding platform, in terms of how the mechanics and the technology of the platform work, but we, obviously, serve a completely

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different audience than a crowdfunding platform, institutional investors on one side and non-bank lending and credit transactions on the other side. In terms of functionalities, there are a lot of similarities.

Peter: Yeah, yeah. So then, you made a name for yourself, obviously, in the online lending space working with the likes of Lending Club, Prosper and others, are those the types of platforms you're working with? I presume you're casting a broader net when it comes to originators than just the online consumer lending platforms that you worked with before?

Jon: Sure. So, I've believed for many years now that there is a big opportunity in what I call non-bank lending and online lending is a component, it's an important component of the non-bank lending theme, but it's the only component, nor is it even a majority. There are literally thousands of non-bank lenders around the world who need to access capital and some of them are visible lending platforms. I won't name names, but names that are in the press often and names that emanate from Silicon Valley, or from Wall Street, you know, those are not necessarily our best clients.

We get a lot of clients who are more on the path, they have excellent credit, they represent excellent credit, investment potential, but they’re not terribly visible to Wall Street, or Silicon Valley and there are literally thousands of these. They're in places like Kansas City, Missouri and Tampa, Florida and Detroit, Michigan and Toronto, Canada, etc. So, a lot of our clients are, you know, fairly well established, but less visible, specialty finance companies. Some are tech-enabled, some are not, but they're around the world and they span a number of different asset classes.

Peter: Okay. So then, let's talk about these originators, I mean, it's not like you have a hundred competitors doing the exact same thing as you. I imagine, it's a binary choice in a lot of ways, they either use you, or they do it themselves so, why do the platforms.....why would they rather work with you than just run the process themselves?

Jon: Yeah, that's a great question. Every non-bank lender has a different story and they come to us for different reasons. Some simply want far more capital than they currently have available to them and we field these off them. We hear management teams talk about how they see just an amazing number of lending opportunities that they cannot capitalize on for lack of capital, so that's one reason.

Others want to lower their cost of capital by having half a capital provider in place, but they like to lower their borrowing cost, or lower their interest rate, others want more flexible terms. So, we have seen lenders, non-bank lenders who have a capital provider in place, may even be a low cost capital provider, but that capital provider may not allow them to deal with everything that they want to do. In many cases, this relates to loan size so there are often restrictions around size of loans that you can originate.

We also see restrictions around credit quality and also the types of collateral that a capital provider will allow the non-bank lender to post for their credit facility. So, every story is different,

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but whatever the need is, a non-bank lender can typically benefit from tapping into a network that is far larger than their own network and that's what Finitive allows them to do. Currently, we have a total of over 500 institutional investors formally signed up on the platform, we have several thousand, actually north of 30,000 institutional investors in our CRM system and several thousands that we have regular communications, or dialogue with who may not necessarily be signed up on the platform yet.

And so, a non-bank lender can instantly, securely, confidentially get in front of a very large universe of investors who specialize in these types of transactions and typically.....you know, when you increase your exposure, the probabilities are you'll get more term sheets and more financing options and I go back to that list of you want more capital, you want more flexible capital, you want cheaper capital. But, the more capital sources you can connect with quickly, the more likely it is that your capital needs will be satisfied.

Peter: Yeah, that makes sense, that makes sense. So, what you're doing is...is it all debt, are there any kind of...you know, obviously, some of these deals sometimes have equity kickers, I mean, is it pretty much all debt that you're doing?

Jon: The majority of our transactions are all debt, we have had a couple of transactions that had debt plus warrants. We are approached frequently by non-bank lenders to help them raise equity capital and so far, we've primarily referred those groups to some other partners that we have who specialize in equity capital.

Peter: Okay, okay, that makes sense. So then, what's the sweet spot for these deals? Are you talking like $50 Million, $100 Million, $200 Million, what are the sizes of the deals that you're interested in?

Jon: Sure. Most of our transactions start at $50 Million and it works up from there. We had a couple of transactions in the half a billion to billion dollar range and those have been from the war zone and exciting to see close. For smaller deals, we also have a program that we call our Referral Program. So, we have some investors, generally, smaller funds, smaller banks who are interested in looking at smaller transactions off platform so, we have a number of referral partners that we send smaller deals to.

If we see a good transaction, we want to be helpful however we can and even if we don't sponsor it directly on our platform, we'll try to make a non-bank lender some sort of an introduction that could be helpful to them.

Peter: Right, okay.

Jon: But our typical size, I think our average deal size is probably in the $100 to 150 Million range, but we sponsor deals smaller than that, we sponsor deals larger than that so, it's a fairly large range.

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Peter: Right, okay. So, we're recording this on May 12th and so we're about two months into this economic dislocation caused by the corona virus, and I'm curious about the impact on your business and deal flow, specifically. I mean, have you seen....in recent weeks, has there been a dramatic decrease in the amount of deals that are getting done, or even trying to get done?

Jon: Sure. We've certainly seen a number of investors pull back on their activity, there's no question about that. Investors are taking longer to perform due diligence, some investors are changing deal terms that may have been agreed to pre-COVID. So, we've seen some term sheets that were agreed to, prices pre-negotiated with higher interest rates and there again, there's a pretty wide range that we're seeing. But, generally speaking, if you look at a credit that's already....that was negotiated pre-COVID, if I had to guess, an average I would say we see 40 to 50% wider spread than what we saw pre-COVID.

For example, someone had a LIBOR + 200 credit facility negotiated ten weeks ago, that's probably a LIBOR + 300 credit facility in today's environment. You know, I'm generalizing, but if I had to guess, on a number of deals, it's 40 to 50% widening of spreads. So, spreads have widened, investors have slowed down, but they haven't stopped and I think that's where this is very different from the last financial crisis. We've, actually, continued to see new term sheets post-COVID presented to originators and in fact, we haven't announced this yet, but last week, we actually closed a fairly sizeable deal and hope to announce that shortly.

This is a deal where client came to us in the middle of March, who engaged us and literally, within six weeks we had a multi hundred million dollar credit facility lined up and it was closed last week. So, we are seeing activity, we are seeing our user base grow on both sides of the platform. So, we had almost no interruption in terms of non-bank lenders and on the other side investors signing up on our site, it's been fairly steady there.

On the non-bank lender side, an interesting trend that we've seen in the last eight weeks is we've seen a higher percentage of large well-capitalized non-bank lenders coming to our platform than we've ever seen in our history and we were founded about two and a half years ago, but we are seeing a number of very high quality groups coming to us searching for capital. So, even larger, established companies are having some struggles in this environment and companies that perhaps eight, ten, twelve weeks ago would have raised capital on their own, that's been a very interesting trend that we've observed.

Peter: Right, and what about across asset classes? Are you seeing certain asset classes being stronger than others and investors more willing to put in to certain asset classes than others? I mean, how is that changing?

Jon: Sure, so it's a great question. I think pre-COVID, you have a number of credit funds and other groups that traditionally focused on distressed credit opportunities who really had nothing to do, therefore, there's very little distress in credit for many years. A number of those pockets of capital had to re-position themselves in order to stay in business and so, a lot of those groups were funding new originations, whether that was through home sale programs, or credit facilities

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to online lenders, or non-bank lenders, in one way or another, they were providing new capital for the sector and that segment of the investor base has really re-positioned that towards their core which is providing funding to distressed companies which comes at a significant premium, where those companies may have borrowed prior to the downturn and also purchasing secondary portfolios and other distressed assets so, I think distressed and secondary sales are a big theme.

Another theme that we're observing, which may not come out as a surprise, is just to focus on highly secured opportunities with major focus on return of principal and safety of principal. So, those are the things we've seen, there's a big move if you look at the banks, our platform....the banks are really focused on well capitalized borrowers. I think a lot of the marginal companies and, unfortunately, I don't say this in any way of rejoicing, but, unfortunately, a lot of startups are just getting rationalized and, you know, won't have access to credit for some time to come. There's a big focus on the bank community on high quality, well-capitalized borrowers, we are also seeing certain asset classes, and I'll give you one or two examples.

There are certain asset classes that have incredibly short duration, very short maturities and those asset classes are seeing a lot more interest from the investment community because the legacy problem pre covid through those assets and cleaned out portfolios. As an example, we have one group that we have worked with in buy here pay later space, physically buy now pay later. These are 30, 45, 60-day loans that are originated through online merchants to consumers and at this point, the majority of those loan portfolios have been originated with tighter underwriting standards post-COVID, higher FICO scores, better debt to income, whatever the metrics that you're focused on as related to credit quality.

Credit quality has improved dramatically and so....you know, we are seeing some transactions, asset classes where an originator truly has a portfolio that is entirely underwritten post-COVID and also seeing some success.

Peter: Okay, okay, that's good to hear. Good to hear that there's a ....you know, there are deals getting done and there are still some bright spots, but I'd like to get...clearly, there's going to be some shakeout in the non-bank lending sector and you've got obviously a pretty good window on that sector now. I mean, do you see many of these originators just not making it, how do you feel....obviously, you've done your due diligence on many of these, but how do you feel about the non-bank lending sector and the impacts that this crisis is going to have over the long term?

Jon: Yeah, that's a great question. It's unfortunate that we're having these conversations right now and, unfortunately, if you think a number of non-bank lenders will close the doors, we've seen many groups that we speak with completely shut down their originations in recent weeks. A few have started back-up, others are still on hold and, you know, there's essentially that chain reaction of defaults that maybe could stop at this point and I caveat that again by saying, I hope I am wrong, they have a number of borrowers, whether those are consumers, whether those are businesses, whether those are real estate owners, whether those are auto owners, or students. A number of borrowers have stopped paying their debts. I don't think… this has all happened so

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suddenly, I don't think we've had a chance yet to synthesize and process and quantify if we have this crisis on credit, but, certainly, delinquencies are going to go way up. That means that a number of non-bank lenders will, in turn, have difficulty paying their loans to their institutional investors and thus, this chain reaction unfolds and creates a lot of economic and personal and other types of damage.

So, I think the government has reacted as quickly and as aggressively as they've been able to, given the circumstances, but this chain reaction can be very difficult to stop once it's set in motion. So, I am hopeful that I'm wrong, but certainly we are preparing our business for what I would call an L-shaped economic recovery as opposed to a V-shaped recovery. So, we will see a lot of consolidation on an on-bank lending sector and there will be a transition of asset ownership from well-capitalized groups, sorry from less well capitalized groups, the last well, the well-capitalized groups and this just has been a natural part of the credit cycle and it's unfolding as we speak.

Peter: Yeah, yeah, it is indeed. Okay, we're switching gears a little bit, maybe can you give us some sense.....you know, you said you've been in business two/two and a half years, but what kind of scale are you at today. Can you give us some sense of maybe total number of deals, amount of capital raised?

Jon: Sure. We have raised north of $2 Billion of committed capital across our clients, we had roughly 15 clients and that number is swelling pretty rapidly. We, actually, have more clients today in our pipeline than we've ever had in our history, but we've raised over $2 Billion across , call it a dozen plus clients over the past two years and you know, we're looking at some of these numbers pretty significantly over the next year, or two.

Peter: Okay. So, what about your own capital needs to operate your company, have you gone out and raised money for Finitive?

Jon: We did. So, a little over a year ago, we raised close to $6 Million in a seed round, we're actually self-funded for the first year, or so of our history, self-funded and funded with revenue. We were revenue positive from day one, but, last year, we did raise a round of venture capital from Atomic Labs. I've known the Founder of Atomic Labs, Jack Abraham, for many years, he was an investor in my first company and we've really enjoyed the relationship with Atomic.

And then last fall, we raised a round of venture debt from Silicon Valley Bank and that was a $2 Million credit line and they sent that past the partners as well. It is possible that we will go out at some point in the future and raise additional venture capital, but for now, that's what we've put in place.

Peter: Right, right. Okay, we're running out of a time, but a couple more things I really want to get to. One is, when you look at these non-bank originators and you said some of them are tech-enabled, some of them are not really, I mean, what should they do to improve....I'm thinking, operationally, what can they do to improve operationally that will increase their chances of obtaining funding.

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Jon: Yeah, that's a great question. One thing that we recommend to all of our non-bank lending clients as soon as we hire them is that they have a Field Exam performed. A Field Exam is sometimes described as a forensic audit and you can get a field examiner who will come and visit your office, that's a little bit difficult these days, but they will perform a review of all your processes, your procedures, your risk management, your corporate governance, your adherence to your written underwriting standards and the list goes on and on.

I would recommend, even if you don't have an institutional transaction that you're contemplating in the near future, I'd recommend getting a field examiner into your office, get him to inspect your operations, inspect your internal controls, etc. and advise you on what changes you can make today so that when you're ready for institutional capital, you can pass an inspection of that sort.

I would say 95% + of our investors will require a Field Exam and, if you're not ready today to pass the Field Exam, you won't be able to change your operations overnight. It can take weeks, if not months to make the changes required to pass one of those inspections. So, that's probably the best advice I can give, to institutionalized their business.

Peter: Okay, that makes sense. Last question then, for your guys, sounds like, you're not planning on major changes to your strategy going forward. I mean, are you looking at this year.....it sounds like you're looking to still grow the business, I mean, maybe you can give us a sense of how you see the rest of the year planning out for Finitive.

Jon: Sure. As I mentioned, we have a very strong pipeline at the moment, we are working very hard to satisfy the clients in that pipeline and put the capital in place that they need to continue funding their operations. We do expect that to continue to grow, whether that is measured by capital commitments raised, number of clients, even our headcount, I think, we're looking at expanding on the second half of this year. So, I wouldn't exactly say it's business as usual, this has been a very unusual time, but we continue to move forward and execute the business strategy that we had in place from day one.

Peter: Right. Okay, well best of luck, Jon, it was great chatting to you again and I really appreciate your coming on the show.

Jon: Thanks again for having me, we appreciate it.

Peter: You bet, see you.

You know, I agree with Jon there. I actually think 2020 is going to be remembered as the year where there was the culling of the heard in the non-bank lending space. There certainly are....across every asset class, there are companies that are struggling and companies that continue to do okay. Certainly, the well-capitalized ones, the ones that have really been able to generate profits, generate cash flow, are going to be in much better shape to weather this storm than those that really are still, you know, cash flow negative and trying to claw their way to profitability.

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I think those kinds of companies....it's going to be very difficult for them to survive the next 12 months and we're going to see a lot of distressed sales of these platforms and there will be some that would just go completely out of business. It's what we're seeing, but I think, like anything, when these things happen, the strong will survive and I think the industry, as a whole, will be better for this in the long run.

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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