PODCAST TRANSCRIPTION SESSION NO. 98: DAVID KIMBALL

Welcome to the Lend Academy podcast, Episode No. 98. This is your host, Peter Renton, Founder of Lend Academy.

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Peter Renton: Today on the show, I'm delighted to welcome David Kimball, he is the new CEO of Prosper. Now he's a name that not everybody knows so I wanted to get him on the show to introduce himself. He's only been in the industry for a bit over a year, he has got a very deep history in financial services, but he's relatively new to this space so I wanted to get him on the show, talk a little bit himself, his background, but more importantly, what's been going on with Prosper. We talk about the $5 billion deal, we go into some depth there, we talk about the state of their business today and what they're working on. It was a fascinating interview and I hope you enjoy the show!

Welcome to the podcast, David.

David Kimball: Thank you, happy to be here.

Peter: Okay, so let's get started. I mean, a lot of people don't know that much about you so why don't you give us a little bit of background about yourself and what you did before you came to Prosper.

David: Yeah, no problem. I've been in a financial services role for about 20 years. I spent the first ten years of my career with Ford and Ford Credit and the last ten years of my career at USAA and then I've spent the last year at Prosper. So my jobs have ranged...you know, at Ford I started off as a Plant Financial Analyst doing budgets for a plastics plant and before I left Ford, I had the opportunity to run their securitization program, both in the US and in Europe. I also had the opportunity to be the Treasurer of Ford Credit of Europe and at the end, I was dealing with financial strategy for Ford Credit in general, really at the time that they had been dealing with Firestone and a number of downgrades so it was kind of an epic time to be there. Great group, really enjoyed being there.

And then I spent ten years at USAA where over the course of that time I also was in both treasury as well as finance. I was the CFO of its bank during the recession and I was the Treasurer of the company. Before I left, I was the CFO of the overall operations which included banking, insurance, investments as well as real estate. So it was a great experience to be at both of those companies, but I've really enjoyed my time here at Prosper for the last year.

Peter: Okay, so you were hired as CFO and you held that position for I guess less than a year and now you've become CEO. As CEO, I mean, obviously you're setting the tone for the organization and many other things. What I'd like to maybe do is just get a sense because, you know, Prosper has been in the news a lot, some positive, some negative stories over the last year or so. What's the mood like inside Prosper today?

David: You hit it, I mean, there's been positive and negative and I would tell you, about a year ago, we saw certainly more negative than positive and I think it was really hard as a company. Here's a company that had been really on a massive trajectory and had attracted a phenomenal workforce and everybody had been used to seeing growth all the time and really seeing pieces on us that were consistently positive. So when that began to go the other direction, I think it was difficult for people; it's something they hadn't seen before and what I give this team a lot of credit for is they really have been able to buckle down through what I think was a tough year for the industry.

Clearly, it was a tough year for Prosper as well and really look around and say, alright, let's remember what our mission is about. We're here to facilitate the financial security of our customers and let's make sure that we're mission focused and ensure that we're doing a phenomenal job and if we're doing a phenomenal job then we can turn that around. We can ensure that the future press ends up being positive because we are successful in what we're doing. And I'll tell you, over the last…call it six months, I've really seen a turnaround here; you can feel it on the floor, you can feel more enthusiasm.

We went through a reduction in our workforce and that's hard when you see a number of your co-workers that you value...we're just not in a position that we can do all the things that we'd anticipated doing so we needed to reduce that workforce and it's tough. So I think what the group has really rallied around is, let's make sure that this is a company that everybody is proud to be a part of; proud to have on their resume and I think you really do see that now.

We've seen growth in our originations from July through March and we were able to sign the consortium agreement which gives us some stability there and we've been able to do a lot of just great technical things as well, launching a new credit model and I think that just gives the employees an ability to rally around it and we're really seeing that now.

Peter: Okay, I want to talk about that consortium deal in a little bit, but firstly, let's just go back. You've been CEO now for...I guess it was December when Aaron Vermut stepped down, what has been your biggest challenge, so far? You know, you've taken the reigns of a company that obviously...it's back on the upswing, but had a pretty difficult 2016, what's been your biggest challenge so far?

David: You know, I would tell you it's probably a mindset shift. I think being the CFO during the troubling time, you end up I think playing a little bit more defense than offense. Sometimes it feels like you're playing not to lose something and as a CEO you just don't have the ability to do that. Fortunately, as a company we moved the momentum to a place where it's easier for us to play offense instead of playing that defense so I would tell you, the hardest part was just making that transition.

The great news is I have a CFO on with us now who is phenomenal and it allows me to be able to work with him so that all the things that I concentrated on as a CFO, I don't have to pay as much attention to that because I have this great CFO in that role right now and it allows me just to look more broadly. Like I said, playing more offense, play to win rather than playing not to lose.

Peter: Sure, and given the fact that you are still relatively new in the industry, I mean, you've obviously been in financial services a long time, but not in the marketplace lending space for a long time and as you pointed out, you said that this was an industry that was just growing and growing and growing. Before we had the Lending Club challenges in May of last year there was already a down swing and then you guys announced your layoffs I think it a week before that, but the question that comes to my mind is why do you think...I mean, you look at the numbers, the origination numbers for Prosper and you look at them for Avant and Lending Club and the different competitors that we have and it looks like Prosper went down further than anybody else.

Why do you think 2016 was so challenging for Prosper? It was challenging for everybody, I'm not trying to paint it as Prosper had the only challenges, it was challenging for everybody, but it seems like Prosper had it particularly bad so why do you think that was?

David: We had a pretty decent investor concentration and as a result by not having a lot of diversification there, when you have just a couple of institutions move off, then it has a pretty significant impact on your volume. I think we were actually in a position where we had a lot of people in the wings coming in to the program, but I guess we hit that exact wrong spot where they were still on the sidelines when Lending Club had its issues.

And as a result a lot of people just said...you know what, this space is a little too hot for me right now, I need to have some time for this and so over the course of...that announcement was in May, to July, which was our lowest point, we just had a lot of people pull off. I say a lot of people...we had a handful of investors pull off and we were not in a position to bring in the new investors.

Peter: Right.

David: And we chose not to maybe artificially increase our volumes…certainly there is a temptation when you have volumes go on for so long and this is an industry that has been focused on volumes and using that as a measure of success, there was almost a muscle memory that said, we need to have that volume or we're going to go down and really we decided no, we need to have equilibrium.

So we used it as an opportunity to shore up our processes, we used it as an opportunity to tighten our credit and we used it as an opportunity to look at our marketing channels to ensure that we really were doing the right thing and it wasn't just about growth. So certainly, for an industry that uses originations as the measuring stick, it looks like we had a much worse situation than a lot of our peers and I would tell you, that was a conscious effort to bring the level of equilibrium to a different stage such that we can get to a more sustainable company at a lower level than we were tracking to before.

Peter: Right, you make a very good point because I think the industry itself has been in love with originations as the major metric and I think that's come from a never ending growth and the VC community and the other investor community love to see that growth. I do think that's changed now, I think now it's much more about building a sustainable business. I guess a followup question from that though is now that we're obviously several months, almost a year away from July when you had said you had your lowest point...I mean, given the fact that volumes obviously now have increased substantially off that low point, what is different now with the investors that are coming on board than what was on board before the downturn?

David: Well, obviously for us we have the consortium in play right now and that's a significant part of our originations. That was meant to be able to show stability and confidence in the platform and it's done exactly that. It's allowed us to be begin to attract additional investors who candidly up until that time…the question had been when is this consortium deal going to get done and within the day of the announcement it shifted to...wait, is there enough collateral for me?

And that's a great problem to have, it's nice to have scarcity and as a result it's allowed us to have more conversations with different investors that were not necessarily on our platform before that have been waiting on the sidelines for half a year just ensuring that we were able to get to resolution on the consortium transaction.

Peter: Yeah, so that obviously was a big deal and I know it was leaked in…I think it was August of last year, it took quite a long time to actually get over the finish line, it sounds like but I mean, we knew about some of the issues. You obviously had the pending thing with Colchis that's being talked about which I don't really want to get into today.

So the consortium coming in now, how has that changed your business, I mean, you obviously gave away a lot it sounds like, getting this deal on the table but you obviously thought it was worth it, but how has that changed the business? You said you've got now much more investor interest, do you feel like this now puts you in a place where you were a year or two ago?

David: It's tough for me actually to comment on where we were a year or two ago because I've been here just a year, but what I would tell you is the intention is to provide us more investor diversification than we had a year or two ago.

Peter: Right.

David: And really as we approach the volume doing it in an even more measured pace than we had done previously. So the irony of the interaction with the consortium is they were buying from us over the course of that period even though we didn't have the transaction completed and what it allowed us to do was to slowly ramp up the volume to ensure that the volume that we were bringing in was, here again, more sustainable than it has been in the past, that it was at a level that made sense economically for us and for the investors.

And so what we've been able to do and what we will do going forward is ensure consistent measured growth and that's where I think that consortium base ends up helping us and by working with them and providing equity as part of the incentive with the consortium, we do align our interests. They ultimately want us to see long term success because they have an equity investment in us as they continue to buy and so that's a great partner to have when you're having somebody who's buying loans from you who wants you to ultimately have other people buy loans from you, to have you be an even bigger success. They have no reason to be selfish in this regard. They want to be able to share our success with everyone because ultimately it will make them even more successful as equity holders.

Peter: Right, given the size of this consortium deal and I don't know, you said it's up to $5 billion over two years and given where you are now, don't you run into the same risk of having one large investor dominate the volume and sure their interests are aligned and they're not just going to pull the plug like others might, but still you talked about diversity of investors. Do you want to have this consortium be 50% of the platform or 10% of your platform? I feel like given how big it is you run the risk again of having more eggs in one basket than what you would like.

David: Certainly near term it is going to be a significant part of our program and the long term though...this is viewed as a bridge and this is the way we've communicated it within our company and externally to other investors. This is a bridge of stability over the next couple of years that allows us to get to that diversification over the course of the two years.

So it would be really mismanagement on our part if we ignored the fact that it was investor concentration that put us in a disadvantage over the last year and for us to follow up in two years from now and have that same investor concentration would certainly make this investment not as worthwhile as it otherwise would have been. So the clock is ticking, if you will, for us to be able to use this as a bridge to show the investors collectively the confidence of the consortium and the strength of the company which then enables us to be able to bring others on to the platform as they see that stability.

Peter: Right, okay so talking about others that are coming on to the platform, I don't know what you can share, but, you know, you've had banks that are equity investors in Prosper and I know that there's been some banks that have said publicly they are investing in the loans of Prosper, but, where are you at with talking with the banks these days? Is there anything you can share about the banks that are coming on board to buy loans today?

David: We really don't usually comment on that. Clearly, the consortium was a difference there, but that's one where the investors themselves will determine whether or not they want to make an announcement. We typically shy away from making those comments other than to say that we continue to get interest and we are bringing new investors on really a weekly to monthly basis, just depending.

Sometimes there's a due diligence cycle that takes a long time, sometimes it's shorter and so in any given week you're going to see more investors come in, but ultimately, the announcement of those ends up being predicated on the desire of the investor to make an announcement.

Peter: Right, understood. So what about retail investors? I want to talk about them for a little bit; I am one of those. Obviously, you have a decent sized retail base, but there's been I guess a sense inside Prosper and Aaron Vermut has said it multiple times previously that Prosper intends to focus more on the retail investor and we just haven't seen a whole lot of changes. I know there's been a few things that have happened in the last month with changing some of the automated investing pieces, but I want to get your sense of where you're at with the retail investor today.

David: It's a great question and one that I would tell you that I echo the intent. So I think the retail investor is one of the things that makes this space attractive. I mean, this is a space that started off as peer to peer and you had an ability for an individual investor to have access to an asset class and return that they typically don't have access to and you have an opportunity for a borrower to get a lower rate that they wouldn't necessarily always have access to. Being able to connect those two in a more efficient way than you see in a lot of traditional financial institutions is what we're all about. And so we do want to make sure that we're increasing that access for that individual investor.

You mentioned some of the enhancements we made on the platform itself just making it easier to invest and I will tell you, part of the reason that we didn't do a big media campaign before that is we wanted to make sure that as those individual investors came in they were excited about the opportunity and liked what they saw. We didn't want to bring people in to something that was maybe more kludgy or a more difficult experience. And just as we were launching those enhancements, well the industry itself had some issues that it had to deal with and so those had taken more of our concentration.

Suffice it to say that 2017 you'll see certainly more there. We're seeing an uptick on our investors, our retail investors, which has been fantastic, partially because we have not focused that much marketing on that and so we're seeing a natural uptick there and so we look to be able to build on that little bit of momentum. Certainly we expect to see greater penetration as we go forward on the retail side and so stay tuned as we continue to make those efforts.

Peter: Okay, so based on that, reading between the lines you said there will be some new features or new...or just more targeted marketing to increase the base. I mean, is there anything more that you can say about the retail investor?

David: Suffice it to say that you'll see marketing, you'll see features, you'll see other things just to make sure that we can attract the right investor base there.

Peter: Okay, that's fair enough. One of the things…I report my returns every quarter and go into all of the details and the reality is this what I talk about privately with many, many investors. People want more access to Prosper, they want more loans and they want a more variety of loans because you guys...the returns at Prosper, frankly, have been really good over the last two years where others have not done as well.

So I think there is…and privately, when I talk to people there's a lot of appetite, shall we say. What we worry about…when we talk privately what we worry about is Prosper is just going to shut down the retail platform because there isn't a whole lot of volume, it's got to cost money and that's something that obviously we don't want to see. It sounds like from what you're saying is that's not even on the table.

David: It's not, I mean, there are really two ways to approach that. You can either make the size sufficient that it's appealing or you can shut it down and we are certainly of the mind that we're going to make the size sufficient that it's appealing.

Peter: Okay, okay, fair enough, so let's talk about cash. You've been CFO, you're obviously keeping a very close eye on the numbers. We know it's been two years this month since your last fundraise and we know that you did burn through a lot of cash last year as did everyone in the space, it seems like. So are you looking to raise money again soon or do you have enough runway to get you through to being cash flow positive again?

David: Yeah, I think, to answer really both of those questions, we're certainly open to investors to the extent that more want to invest in the equity side here. We're not necessarily on a road show right now obviously to do something like that, but ultimately for us to be attractive we need to run a really good business.

One of the hallmarks of running a really good business is as we talked about earlier is we want to be in a position where we're generating cash. So it's much better to be able to go to those investors and say, hey, invest in us because we want to be able to use this cash to be able to increase our growth or to be able to find a strategic alternative here.

What you don't necessarily want to do is go, I need to raise more cash because I'm burning through my cash. Those are two different equations and so the best thing we can do is what we've been doing over the last year is right sizing our business, putting ourselves in a position where we can be self-sustaining and then it becomes easier to have conversations about valuation and about the amount of cash that we want to have in that case; certainly open to it.

Peter: I know you guys were cash flow positive in the past, I mean, do you have a sense of how far away you are from being that again? Is it going to happen this year, can you give us some sense of a timetable?

David: It will happen this year. I expect us to be pretty darn close in the second quarter so if not second quarter, shortly thereafter.

Peter: Okay, okay, that's really good to hear. And so then let's just talk a little bit about the future. I guess firstly, I want to get a sense of where you are as far as origination levels. I mean, we know…I still don't like it as a metric to determine the success of a business, but given the fact that you're moving towards cash flow positive that to me is still the single most important thing and I think that's what has shifted in the industry, but do you have a sense of what levels you can be at that cash flow positive position and when you might get back to where you were when the business was humming along?

David: Yeah, I would tell you this, in terms of that break even point, we've lowered it pretty considerably versus where it was before so if you look at the 4th quarter of 2015, we originated $1.2 billion and we were not cash flow positive. In the 1st quarter of 2016, we were a $1 billion and we were not cash flow positive. I would tell you that were we able to originate either one of those levels, we would be at a point where we're generating a decent amount of cash so we've lowered that rate. I'm not necessarily going to tell you what quarter we're going to hit the 4th quarter of 2015 levels again…

Peter: (laughs) Right.

David: ...but I will tell you the intent is to be able to take the originations that we see on the horizon right now and be able to ensure a sustainable business based on those originations.

Peter: Okay, so then what are you working on as a company today? When you get together with senior management there, what are the big goals that you're really trying to hit on for 2017?

David: So does it seem repetitive if I say breaking even and ensuring we're generating cash?

Peter: (laughs) No, not at all, that's a good goal. What else though?

David: I think sustainable business is ultimately the biggest goal we have. I'll tell you that as I look at the biggest things for us, certainly the origination goals, because that feeds that cash, is something that we focus on, but certainly not to the levels that we've seen historically, at a much more tame level than was there before.

Consistency in our credit performance, consistency on operating excellence, that's a critical thing for us, but at the end of all of it, or really at the beginning of all of it is employee engagement...what I think we have that other companies don't have is the employees. We have a great talent base here and as these guys get excited about really going on the offensive again, making sure that we're embracing technology in ways that others haven't really anticipated; that's the thing that's exciting here.

We have a great mission and we have a great employee base so the combination of those two really enables us to have a phenomenal year and a phenomenal next couple of years. We, as a management team, need to ensure that as they work this hard, that it's producing good results and I think we're well positioned to do that in 2017.

Peter: Okay, you recently switched from Experian to TransUnion to running your credit models and I'd like to know the reasoning behind that and how that is going to help you going forward?

David: Well, it really allows us to have more of a time series look at the credit picture rather than just a point in time and I would tell you, as I look over the last six months that is one of the big accomplishments that I give this team a lot of credit for. That was something that we accelerated the transition really more than a quarter versus what the original timeline was. This is something that required kind of an all hands on deck look both from the credit team, the engineering team, just aggressively across the company.

As a lot of people know who run these operations...it's great to celebrate when you've launched the new system, but then you've got to disengage the old system and that ends up still taking you a long time. So we were able to really completely make that transition by the end of the 1st quarter and here, again, I give the team a lot of credit for digging deep and being able to work across different groups to ensure that that was able to be pulled off with really one of our best launches, Prosper to date.

Ultimately, what it will allow us to do is it allows us with that time series to be able to say yes in areas that we weren't able to say yes before. And, here again, it helps us to be able to address that mission of being able to put people in a place where they are better off financially than they were before.

Peter: Okay, so we're just about out of time, but before I let you go I wanted to just get a sense of you personally, what are you personally working on today as a CEO that excites you, that makes you really happy to be coming to work in the morning?

David: You know, for me, it's the art of the possible. I continue to tell people when they see what we do...you know, we provide loans, we provide investment, this is not something that's new, I mean, loans have been around since Babylon. This is not necessarily a new space...what I love about this space is the opportunity to do things differently and do it quickly, ensuring that you understand the lessons that we see all around us, but then embracing technology in ways that maybe weren't even anticipated a month ago and being able to provide something completely different in this space.

We, for the last year have dealt with a tough period in the industry, what I'm really excited about is being able to provide that stability and then getting back to the exciting part of this space which is really transforming and disrupting.

Peter: Okay, that sounds great. On that note, I'll have to let you go, but I really appreciate you coming on the show today, David.

David: Thank you very much, appreciate it.

Peter: Okay, see you.

David: Bye.

Peter: The Prosper story is certainly one of survival. Things were looking pretty bleak back in the financial crisis where defaults went way up and they had a cease and desist from the SEC and they got through that difficult period and got back on track.

And then back in late 2012, they had some more challenges, a new management team came in, a new executive team came in and recapitalized the company. Here they are again, they've had a challenging 2016 and have a new leader now and a new perspective and they're back getting on very solid ground again. So I feel like they've done...there's something about Prosper that keeps them kicking, keeps them coming back and I think that 2017 is a critical year for them.

They've obviously got the consortium deal behind them now and cash flow positive before the end of the year is I think going to be another great sign not just for Prosper, but I think for the industry as well. We want many strong companies in the industry and we certainly want Prosper to be a part of that.

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

(closing music)