VPC Viewpoints

Lending to Consumer Finance: A Growing & Dynamic Investment Sector

On February 8, 1950, Diners Club International made its debut as the first charge card to be used as a payment method in New York City restaurants. The card launched with 200 users and 27 participating NYC restaurants and quickly took off in popularity; by 1961, Diners Club had 1.3 million cardholders and was accepted at hotels, car rentals, and flower shops. By the 1970s, FICO credit scores were established, and IBM had created a point-of-sale system for electronic payment processing. In the 1980s & 1990s, credit and debit cards were universally accepted, and technology was beginning to enter the space with early online innovations such as Paypal, Yodlee, and CashEdge. Today, there is rapid expansion and significant development in consumer finance tools and technology, including online money management sites (Mint, Thrive), peer lending (Prosper), buy-now-pay-later (Klarna, Afterpay), and much more.

Victory Park Capital Advisors, LLC ("VPC" or the "Firm") views consumer finance as dynamic and embedded in the broader economic landscape; the investment segment is also a part of its flagship asset-backed lending strategy. Founded in 2007, the Firm has been at the forefront of sourcing and evaluating thousands of emerging and established businesses across a diversified range of investment verticals, including consumer finance. VPC closed on its first institutional consumer finance transaction in 2010 and has since financed notable consumer finance businesses such as Avant, Flex, Upstart and Zip, among others. VPC has expanded and deepened its expertise over 15+ years of investing in the space, as financing opportunities have evolved from generic personal installment loans to more targeted point-of-sale financing. The Firm currently has exposure across a diversified landscape of investments, including buy-now-pay-later (BNPL), credit cards, installment loans, lease-to-own, and debt consolidation.

VPC expects a continued evolution of online lending, with lenders developing even more specialized products to meet the needs of specific borrowers.

Below are the Firm's observations of lending to the consumer finance industry:

Never Bet Against the U.S. Consumer, but Pay Particular Attention to Where to Lend

In 3Q 2024, personal consumption expenditures represented nearly 68% of the U.S. GDP[1], with debt funding an increasing proportion of consumer spending: in 2Q 2024, total household debt in the U.S. reached a record high $17.94 trillion, a 3.8% increase from 12-months prior[2]. Similarly, retail sales, a key measure of consumer activity, increased 2.8% from 12 months prior when measured in October 2024[3]. Clearly, consumers are a dominant force and play a vital role in driving the U.S. economy.

1) *Source: U.S. Bureau of Economic Analysis.*
2) *Source: Federal Reserve Bank of New York, Center for Microeconomic Data, "Household Debt and Credit Report, 3rd Quarter, 2024.".*
3) *Source: U.S. Census Bureau, "Advance Monthly Sales for Retail and Food Services, October 2024," November 15, 2024.*

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flex.

- **Flex, Inc.** ("Flex") is a B2B2C bill financing platform that allows consumers to spread out their non-discretionary expenses over the month to better align with their personal pay cycles. Flex currently focuses on the consumer rental property market through direct integration with property management companies, landlords, and online payment portals. Flex is headquartered in New York, New York and current has 200+ employees.
- **Initial Investment Date:** October 2022
- **Peak Portfolio Size:** ~$315 million
- **Sourcing**: Direct relationship through equity partner

sunbit

- **Sunbit, Inc.** ("Sunbit") is a differentiated point-of-sale financing provider within the small business, brick and mortar retail space. Sunbit is headquartered in Los Angeles, CA and currently has 500+ employees.
- **Initial Investment Date:** October 2017
- **Portfolio Size:** ~$350 million+ ($230 million in VPC borrowing base)
- **Sourcing:** This investment was sourced directly through a relationship with the founder and the largest equity partner at the time (Chicago Ventures)

However, VPC pays close attention to *where* on the consumer spectrum to lend. The Firm is highly selective and often lends to 'needs-based' consumer financing vs. 'discretionary' consumer finance. For example, companies that provide dedicated funding for rent or car repairs are a top repayment priority for consumers in contrast to discretionary purchases, such as concert tickets, electronics, or vacations. Two examples of 'needs-based' consumer finance businesses financed by VPC are highlighted above[4].

Additionally, VPC assesses each consumer lender it works with to ensure that the companies offer products that are structured fairly for consumers and are not predatory.

Structuring is Key

VPC believes that, given the proper structuring and pricing, consumer credit can offer attractive risk / reward characteristics in the face of macroeconomic uncertainty. As with all its investments, VPC seeks to structure its consumer finance loans to lend against liquidation value and demonstrate resilience to significant stress in any economic environment. The investment team spends tremendous time structuring its deals with a focus on i) maintaining discipline on attachment points, ii) strict collateral eligibility criteria, iii) tight performance covenants, and iv) diligent operational oversight, amongst other considerations. VPC typically invests through highly structured senior secured, delayed draw term notes with first-loss equity subordination, dynamic borrowing bases, and robust covenant packages, which are specifically tailored to the type of collateral being financed. For consumer finance, there are many credit dimensions that the Firm considers in assessing underlying collateral, including duration, margin, security, diversification, use of proceeds, and so on. While credit quality and indicators (i.e., FICO

4) *Sunbit is a fully realized investment as of October 2024.*

score) provide useful information, they are just one of the multiple factors VPC considers in underwriting a consumer finance investment for optimal performance in a VPC fund.

Institutionalized Risk Management: Transparency is Fundamental

Risk management is integral to VPC's mandate of generating attractive, risk-adjusted returns for its limited partners. Regardless of investment vertical, VPC's risk management systems and processes require significant adherence to transparency by portfolio companies, including:

- Contractually mandated detailed transparency into all aspects of the portfolio companies' business and collateral regularly
- Data sharing, detailed reporting, and access to management and directors
- Rigorous portfolio and asset-level analytics
- Transparency into bank accounts with deposit account control agreements (DACA) in place

VPC's proprietary, technology-enabled program, *Data Analytics & Risk Technology System (DARTS),* provides both highly granular analysis and broader portfolio-level insight, enabling the risk team to efficiently synthesize information and drive informed decision-making. Consumer finance portfolio companies may be required to provide VPC with data such as:

- Collateral Tapes and Transaction Activity
- Borrowing Base Support
- Covenant Reporting and Compliance Certificate
- Customized KPI Reporting
- Financial Statements and Management Projections
- Cash Balance Reporting
- Board Materials

While consumer spending is often a strong indicator of an economy's general health, VPC does not believe the strong consumer environment seen over the past ten years will continue in perpetuity. As such, the Firm structures its consumer finance sector investments to withstand material stress scenarios and focuses on real-time, proactive risk management. VPC invests significantly in analyzing consumer credit behavior and engages third-party specialists to ensure that its transactions are structured to be resilient to potential deterioration in credit, whether that be idiosyncratic risks to a particular originator or systemic shocks.

With nearly two decades of knowledge, data, and experience, the Firm believes it is well-positioned to source unique, compelling consumer finance opportunities in today's market and generate attractive risk-adjusted returns for its limited partners. ■

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