How Zip plans to catch up to Afterpay

Tom Richardson Jun 8, 2020 – 1.33pm

Australia's buy now, pay later, sector is flying after Zip completed the $403 million acquisition of US player QuadPay last week. Zip's shares surged 39 per cent on the news, as investors heavily backed it to replicate Afterpay's success in the US market.

Both credit card payment disruptors were founded in Sydney, with Zip's 2013 launch just ahead of Afterpay's.

According to Zip's co-founder, Peter Gray, the $11.4 billion valuation gap on its larger rival might not seem so distant if the US deal succeeds.

"It gives us a platform there with 1.7 million customers, growing at north of 100,000 each month. To be a true player on a global scale you need a presence in the US. That's a $5 trillion retail market.

Zip founders Peter Gray (left) and Larry Diamond. The US deal means the "sky's the limit" for Zip, says Gray. ***AFR***

"We observed the business and how it traded through COVID and it was extremely resilient. Very similar to the Zip business in Australia."

Growing up

In Australia, the main differences between the Zip and Afterpay business models are that Zip lends longer and charges a $6 monthly

account fee. Its Zip digital wallet has two products; Zip Pay with borrowing limits up to $1,500, and Zip Money with limits between $1,000 to $50,000.

"We are where the customers are digitally at the point of sale and that's what's leading to rapid adoption," says Gray.

"We do have a significantly more flexible offering, particularly in Australia, than any of our competitors. Our sweet spot is our Zip Pay product, a typical loan is five months. The average balance is circa $400, and the average transaction size about $175.

"So customers can use us as many times in the month as they want and then restructure their repayments to repay the balance."

Zip's business is growing strongly. In April revenue climbed 81 per cent year-on-year to $15.1 million, with customers up 66 per cent to 2 million.

One of the downsides to lending for longer is that the duration of Zip's receivables book is an average of between seven and eight months. Afterpay typically turns over its receivables book in 30 days.

Everything Zip borrows to fund loans to consumers it has to pay interest on and, for the six months to December 31 2019, the weighted average interest rate on its borrowings printed at 4.3 per cent. Receivables stood at about $1.2 billion in April.

"All our receivables are funded off balance sheet in warehouse or securitisation vehicles. We see some significant cost reductions available to us in the short to medium term, particularly when you comp us against providers who've been in the market for longer," says

Gray.

"A new business is probably paying a slightly higher cost of funds until they demonstrate a proven track record. We would think, we could possibly shave 150 to 200 basis points off that over time given where BBSW sits currently."

Minimum repayment models on traditional interest-bearing credit cards can lead consumers to carry debts over an average of seven to 12 years, according to Gray.

"I think that's the way of the past. The younger generation, they're happy to take it [credit] on, as long as it's simple to understand at sign-up and able to be repaid quickly."

Scaling for profit

The QuadPay deal means Zip's outlook has never been better according to Gray, although he notes it st still "very early days" for buy now, pay later adoption in the US.

"The US business duration is about six weeks, with the split instalment model we're using overseas. It's less debt hungry to scale because the money recycles so quickly."

Zip's costs on transactions such as interest, bad debts, and bank fees should grow roughly in line with sales, while other costs, like staff, should decline faster as a percentage of sales, on the path to profitability, he says.

"Initially you build a platform that's scalable, so there's incremental costs, but as you scale all your costs come down as a percentage of

revenue," says Gray. "So it really is a leverage game based off strong unit economics."

It acquired QuadPay in an all-scrip deal at a premium to its then share price and raised more than $60 million cash from investors last December.

"The thesis is we use the money we've raised to accelerate growth in the US.

"They [QuadPay] have a very robust platform. It won't need huge amounts of investment in terms of resources, tech, or people, but a lot of investment will be in sales and marketing to ramp up the scale."

Gray says consumers increasingly prefer the buy now, pay later interest-free model over credit cards and this won't change.

"We really now have a seat at the table to be a force in global payments. The sky's the limit. We are a credit card disruptor and there are shifts globally away from those products.

"We have great relationships with our customers, they actually like us."