

Australia's 'buy now, pay later' trailblazers face test of survival

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Until coronavirus upended the world economy, Afterpay was a stock market darling, inspiring copycats — including economist Larry Summers — to join its advisory board.

But as credit markets tighten, retailers close their doors and many of the Melbourne-based fintech's millennial customers face job losses in the coming recession, the "buy now, pay later" business model is coming under scrutiny.

The sector has expanded rapidly by enabling young consumers without credit cards to buy products such as clothes or electronics without paying upfront. In 2018 at least one in 10 Australians used a digital BNPL service, which, like an old-fashioned catalogue, allows people to pay for their purchases in instalments.

Australia has become a global hub for BNPL companies, with Zip, Sezzle, Splitit, Openpay and Afterpay all listing on the ASX and attracting investment for overseas expansions. Their business models typically rest on providing small amounts of unsecured credit — normally up to about A\$1,000 (US\$580) — to consumers at no cost and charging merchants a fee to process transactions.

The wave of BNPL start-ups has benefited from easy access to funding and light-touch regulation to supercharge

their global growth. But regulators have started tightening rules in the sector and the coronavirus crisis threatens to unleash a credit crunch that could put some of the companies' survival at risk.

Steven Ng, portfolio manager at Ophir Asset Management, an Afterpay investor, said the sector faced a triple whammy from reduced availability of funding, higher funding costs and reduced consumer demand as unemployment spiked. BNPL businesses face an even harder hit than traditional lenders because of their reliance on younger consumers — analysts estimate up to 40 per cent of Afterpay's millennial customers are in casual employment and vulnerable to unemployment in a prolonged downturn.

Afterpay, which was founded in 2014 by Anthony Eisen and Nick Molnar, is one of the world's biggest BNPL providers with 7.3m customers in Australia, the US and UK. It has grown rapidly and last month surpassed a market capitalisation of A\$10bn. But as market turmoil smashed the sector, its shares plunged 60 per cent in just two days last week.

"We are fortunate to have a business model, balance sheet and customer base that creates a level of protection in times of economic uncertainty," wrote Mr Eisen in a letter to shareholders following the share price plunge.

The soothing message did not work. On Monday, Afterpay shares slumped 28 per cent to A\$8.90, taking them even further below an all-time high achieved just a month ago, while the benchmark S&P/ASX 200 fell 5.6 per cent to 4,546.

"The 'buy now, pay later' business model remains untested in a crisis and

things will be tough . . . cash is king," said Siraj Ahmed, analyst at Citi.

Afterpay is lossmaking and has prioritised customer growth over profit. In February, it signalled an expansion into Canada, even as it reported a wider-than-expected loss of A\$35.8m in the six months to the end of December.

Citi believes Afterpay should be able to withstand a six-month crisis because of its strong balance sheet, with a predicted cash balance of A\$370m at the end of 2020. The investment bank says Afterpay's cash burn in the first half of 2020 was A\$60m.

But nothing is guaranteed given the scale of the crisis. A surge in unemployment is expected to increase bad debts and reduce the number of transactions on the company's platform.

Customers who default on their debts to Afterpay and other BNPL providers are typically kicked off the payment platforms, which could dent revenue growth if a large number are excluded during a steep downturn.

UBS predicts Zip Co, a competitor with 1.6m customers in Australia, may be better placed to cope with bad debts because it conducts credit checks on its customers. In a March 13 note, UBS said it believed Afterpay did not know the employment status of its customers.

But the bank warns that Zip's balance sheet risk is higher because of its greater reliance on debt funding. Zip had A\$39.1m of cash and cash equivalents, and A\$984.1m in customer receivables on its balance sheet at the end of 2019, with total liabilities of A\$965.4m.

Long queues of laid-off workers outside Australian welfare offices on Monday hoping to sign on for unemployment benefits suggest that the BNPL model is about to face a very stern test.

Afterpay's millennial customers are in casual work and vulnerable to unemployment in a prolonged downturn

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