Growing pains: Online lenders gain traction but challenges remain
Analysis of marketplace lending

Key takeaways

- Online lenders have faced increased competition from other, more established fintech companies. Furthermore, banks such as Goldman Sachs have started their own lending arms.

- Year-to-date equity investment in online lending startups as of August 3 has already eclipsed the entirety of a challenging 2016.

- Publicly traded firms have made great strides in improving financials; the analyst consensus has Lending Club moving into positive GAAP earnings by year end in part driven by securitizations as a lower-cost source of capital.

- SoFi has made strides towards becoming more bank-like after adding mortgage loans, wealth management services and acquiring (and subsequently shuttering) online bank and money transfer service Zenbanx.

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Marketplace lending update

The online lending space has matured considerably since PitchBook initiated coverage last summer. At the time, the industry was still being rocked by scandal, most notably at Lending Club, and unanswered legal questions in the *Madden vs. Midland* court case. A year later, the largest firms have made progress towards profitability and private capital has continued to flow into the space. Interestingly, ousted Lending Club co-founder and former CEO Renaud Laplanche was able to raise a $54.25 million Series A2 round of venture capital for his year-old startup Upgrade (a similar company to Lending Club yet focused on debt consolidation). Investors in Upgrade who had previously backed Lending Club pre-IPO include Union Square Ventures (Fred Wilson), Sands Capital, Silicon Valley Bank and Apoletto/DST (Yuri Milner).

After the financial crisis, banks began to squeeze all but the best borrowers, and marketplace lenders sprung up to fill the gap in consumer credit. Recently, greater opportunities for online lenders have arisen as traditional institutions have tapered back on consumer lending and credit cards, even as losses have been concentrated primarily in auto loans. Challenges for online lenders remain, however. On the regulatory front, the industry anticipates a new rule from the CFPB that would prevent lenders from inserting clauses in loan contracts that push borrowers to private arbitration rather than class-action lawsuits.

Companies have begun to gain traction by partnering with the incumbent financial ecosystem. Lending Club’s progress in net income can be attributed to a successful commencement of its first securitization program, which helped grow top-line revenues, and partnership with institutional investors. Lending Club brought on 20 new institutional investors in 2Q, bringing its total up to 100 investors, which accounts for 44% of participation in dollar terms. This has contributed to projected positive GAAP earnings by year end as net interest margin has greatly improved in the recent compared to a year ago.

Wal-Mart recently launched a partnership with VC-backed Affirm. OnDeck has partnered even more closely with JP Morgan Chase, signing a new four-year agreement to power Chase’s online small business lending. PayPal recently announced plans to acquire Swift Financial, in order to offer small business lines of credit in order to compete with Kabbage and Square. Both publicly traded payments companies Square and PayPal have greatly outperformed pure-play online lenders in the public equity markets. Startups need to partner with retailers and retail banks in order to compete with (payments) product-first fintech incumbents.
Becoming banks

The trend of fintech companies becoming more banklike has a poster child in San Francisco-based unicorn SoFi. The company has expanded from offering student loan refinance into unsecured consumer credit, mortgages, wealth management and life insurance. However, the company has failed to realize the benefits of banking by using customer deposits as a low-cost source of capital to fund its loan book. The company has continued to rely on its own equity to fund continued lending. The Zenbanx acquisition provided hope that the company was looking to become a bank at least in practice. However, when the company’s agreement with Delaware-based Wilmington Savings Fund Society expired last month, SoFi decided to shut down the service rather than renew the agreement.

Banks such as Goldman Sachs have entered the fray of directly lending money to consumers. Last year the company launched the Marcus lending platform, which offers unsecured consumer loans of less than $30,000. The company has leveraged its large back-office operations in Salt Lake City to compete with lean startups on the cost side. Goldman has more recently shifted into the mass-affluent fintech segment, a similar strategy to SoFi. The firm launched GS Select, a platform for customers of other wealth management firms and brokerages, to borrow between $75,000 to $25 million. The effort aims to help build relationships with smaller asset management firms which may also utilize Goldman’s mutual funds, structure notes and alternative investments as well as enable investors to access capital without paying capital gains tax by selling assets.

China

Meanwhile in China, a massive cultural shift is underway as consumers embrace credit in large numbers for the first time. Even as the government has attempted to temper the pace of elevated corporate debt levels, consumers are more indebted than ever. According to a report from Deutsche Bank, short-term consumer credit is growing 35% year over year (YoY) and still accelerating. Much of this growth has come through online lending platforms and merchants. Shanghai-based marketplace lender Dianrong recently raised a $220 million Series D from
investors including Singapore's sovereign wealth fund GIC. Online lender China Rapid Finance announced that loan volume grew 240% YoY through 2Q. These sectoral tailwinds in China may lend Chinese startups a structural advantage over their US counterparts, and the trend of China containing a disproportionate share of fintech unicorns will only accelerate.

Trends in financing

The willingness of private investors’ to invest in online lenders’ equity has recovered in terms of capital invested, after a challenging 2016. Investment through August 3 has already eclipsed the entirety of 2016 in dollar terms in spite of fewer than half as many deals as the prior period. This has been led by large rounds including SoFi’s $452.9 million Series G venture round, which gave the company a post-valuation of $4.35 billion. The round’s seven investors included SoftBank; that corporation’s interest in the space could be a boon for funding given the amount of capital the Vision Fund has to deploy. The reduction in number of rounds also indicates a maturing of the sector as only the highest-quality and best-funded companies have stuck around to make it to Series A and beyond. In one notable example, Earnest, backed by the likes of a16z and Battery Ventures, has reportedly begun to shop itself around for around $200 million. This would represent a down round for the company, according to The Information.

Investment activity in online lending

![Graph showing investment activity in online lending](source: PitchBook)

*As of 8/3/2017
Select Company Profiles

**Tuandaiwang**

Location: Dongguan, China  |  Year Founded: 2012  |  Capital Raised to Date: $261M  |  Latest Funding Date: May 2017  |  Latest Funding Amount: $261M  |  Latest Funding Post-Valuation: $1,452M

**Description:** Based in Dongguan in China’s Guangdong province, the company operates the peer-to-peer lending platform tdw.cn. Tuandaiwang uses a marketplace model matching retail investors with borrowers. The company touts advanced data analysis capabilities, audit procedures and risk control systems as comparable advantages of its lending platform. A recent growth round in June of $261.35 million with a $1.45 billion post-valuation will be used to scale the technology as preparation for an IPO.

**Kabbage**

Location: Atlanta  |  Year Founded: 2008  |  Capital Raised to Date: $1,078M  |  First Funding Date: December 2009  |  First Funding Amount: $680K  |  Latest Funding Date: August 2017  |  Latest Funding Amount: $250M

**Description:** The company’s lending platform offers automated funding to small businesses. The platform leverages data generated through business activities such as accounting data, online sales, shipping and other sources to understand performance and deliver flexible funding in real time, enabling business to access capital and cash advances. SoftBank completed a $250 million investment in the company in August.

**Swift Capital**

Location: Wilmington, DE  |  Year Founded: 2006  |  Capital Raised to Date: $116M  |  First Funding Date: April 2007  |  First Funding Amount: $6.5M

**Description:** The company provides financial services to small businesses via an online platform. Swift provides working capital advances on short notice, typically arriving in 24-48 hours. The company recently announced that it was to be acquired by Paypal. Previous investors have included First Round Capital, Khosla Ventures, Third Point Ventures, among others.

**Dianrong**

Location: Shanghai  |  Year Founded: 2012  |  Capital Raised to Date: $449M  |  First Funding Date: June 2013  |  Latest Funding Date: August 2017  |  Latest Funding Amount: $220M

**Description:** The Shanghai-based company offers a peer-to-peer lending platform integrated with various third-party payment systems. The company offers loans to individuals and businesses alike. Co-founder and CEO Soul Htite was formerly Head of Technology at Lending Club from 2007-2011. The company recently raised $220 million from GIC, Singapore’s sovereign wealth fund, and several other investors.