PitchBook

EMERGING TECH RESEARCH

Fintech

Q1 2020

Report Preview

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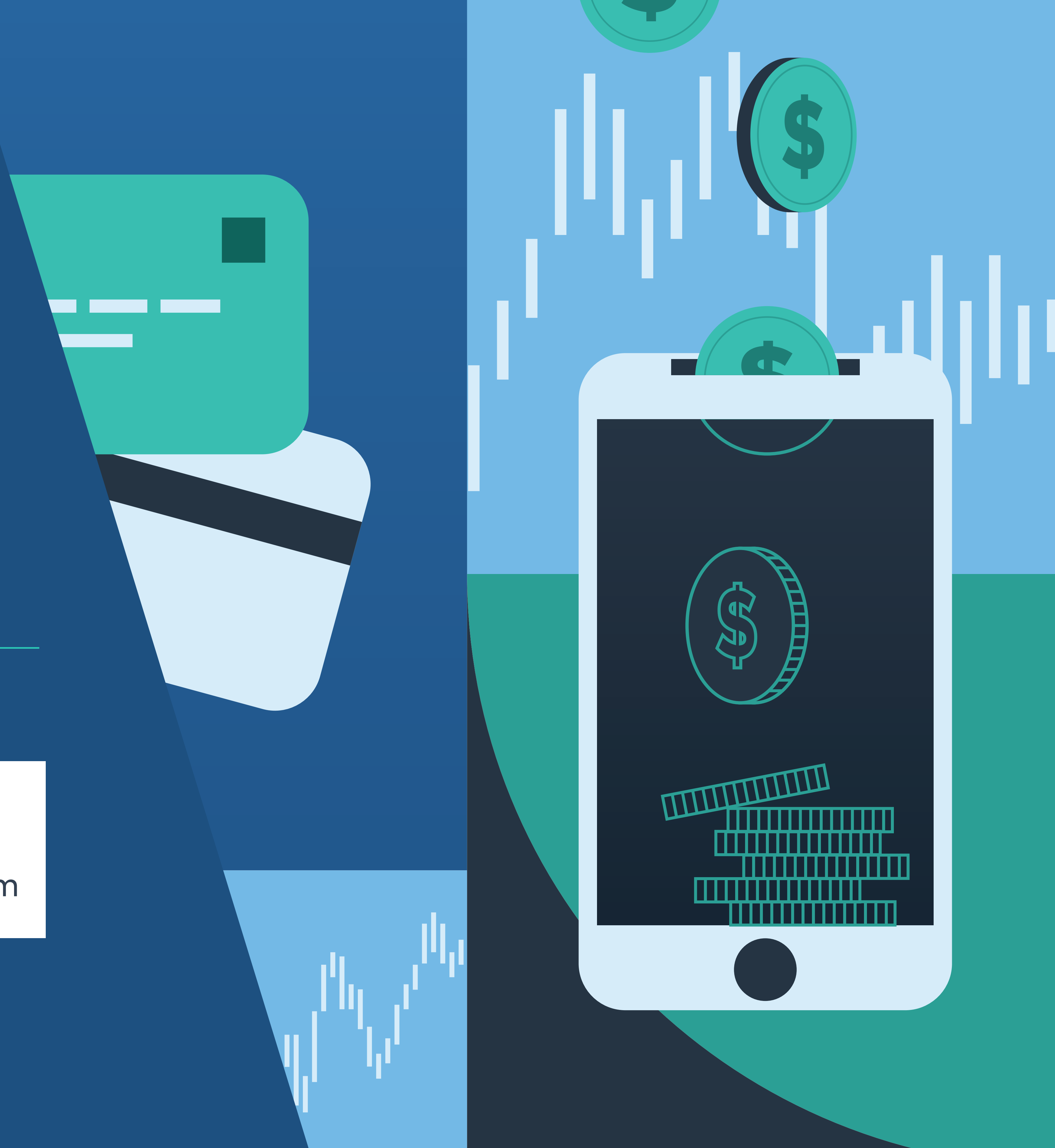

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Executive summary

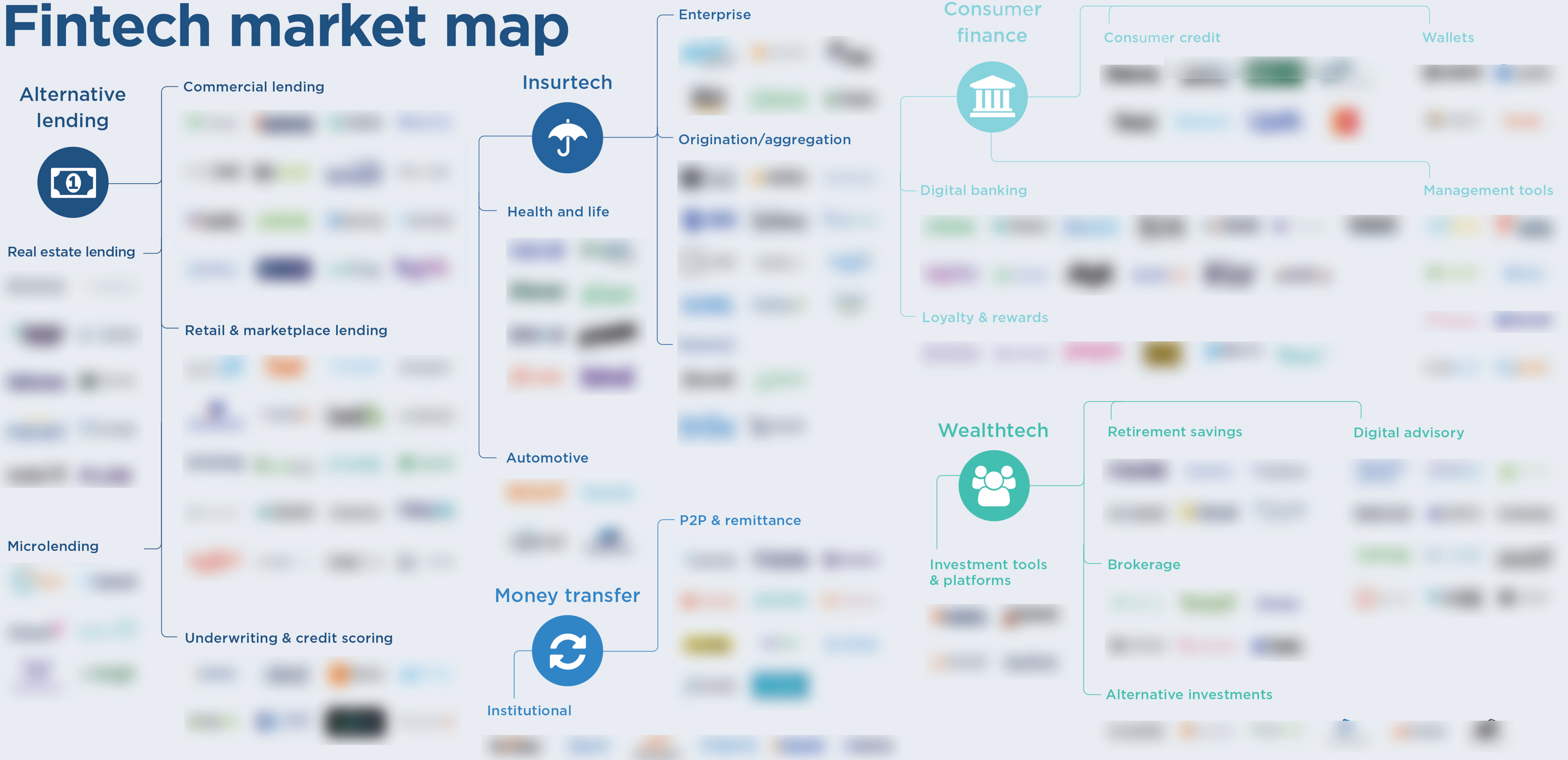
Since the Great Recession, fintech has been one of the most well-funded and fast-growing areas of emerging technology. The expansion of the sector was largely a technological response to the shortcomings of the traditional financial services industry, which came under extreme pressure during and after the global financial crisis. Yet as the COVID-19 pandemic appears likely to spark another recession, the traditional financial industry as well as newer fintech startups appear well prepared to weather this crisis. Widespread regulations and financial reforms enacted since the Great Recession, the creation of oversight committees, ongoing stress testing and capital requirements have left the financial system more prepared to handle the violent economic disruption it is experiencing today. This has been aided by federal efforts to shore up liquidity in the financial system while rapid stimulus and loan programs have helped borrowers meet loan obligations amid an environment of rising defaults. While it is still early and the full impact on consumers is not clear, accommodative measures by financial service providers (payment forgiveness, loan modifications, deferrals and insurance rebates) are likely to help contain the fallout from rapidly rising unemployment.

The financial industry is broad, so the impact of the downturn on certain services will be more severe than on others. Decreased consumer spending will be negative for payment service providers but accelerated digital and contactless payment adoption will drive long-term benefits. Commercial insurtech providers will struggle with increased payouts, but pandemic-related protection could drive new product opportunities. Trading and capital market platforms will benefit from temporarily increased market volatility but still face ongoing secular challenges of commoditization. While lending is likely to decline precipitously as underwriting standards tighten and economic activity slows, government stimulus and monetary intervention programs are likely to prevent the credit markets from locking up. Lastly, despite the probable acceleration of demand among banks for digital transformation initiatives, spending on new technology could remain muted until the economy recovers.

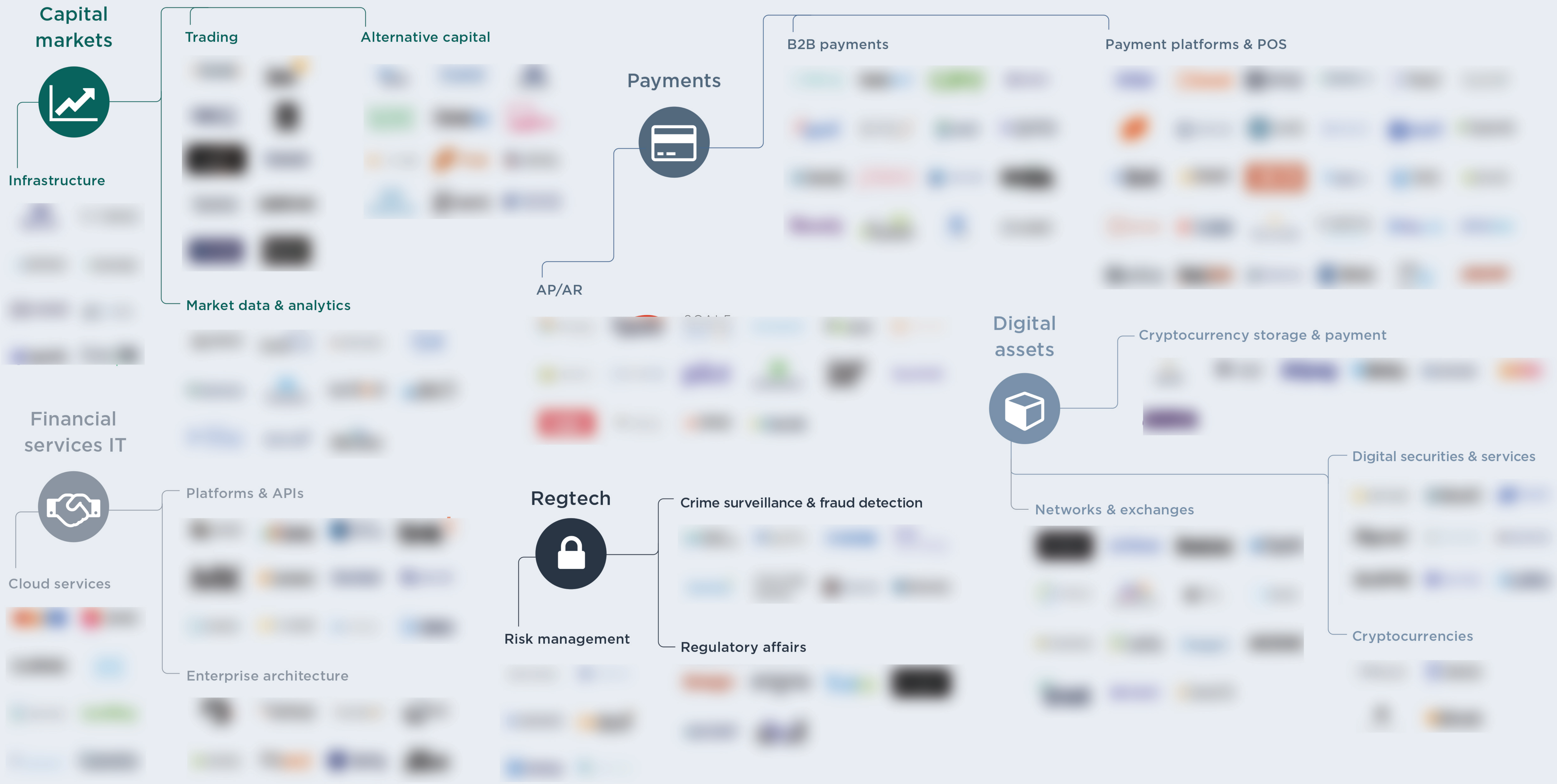
Despite these mixed headwinds and the pandemic-related challenges facing the industry, we believe the long-term opportunity to provide innovative digital financial services remains intact. In 2019, cumulative global investment activity across VC, PE and M&A for fintech companies reached $146.9 billion, surpassing the previous peak of $143.3 billion in 2018. M&A remains the core driver of investment, posting $107.2 billion in overall value in 2019, propelled by massive consolidation among payments incumbents, including FIS' $42.5 billion acquisition of Worldpay and Fiserv's $22.0 billion deal for First Data. While 2020 will likely see a pullback in deal activity and a shakeout among the lesser capitalized startups, we expect continued VC focus on the long-term secular opportunity.

This report provides an overview of the VC-backed fintech landscape in North America and Europe. While the fintech market is large and complicated, we have segmented the industry based primarily on end-market use case. We acknowledge some startups could belong in multiple segments or subsegments, but we have placed them within the categories that match our understanding of their primary use case. The accompanying market maps consist of VC-backed fintech companies in North America and Europe that have raised a significant amount of capital and gained considerable traction within their respective categories.

Fintech market map



Companies included are VC-backed companies in North America and Europe that have raised substantial capital and gained significant traction within their respective categories.



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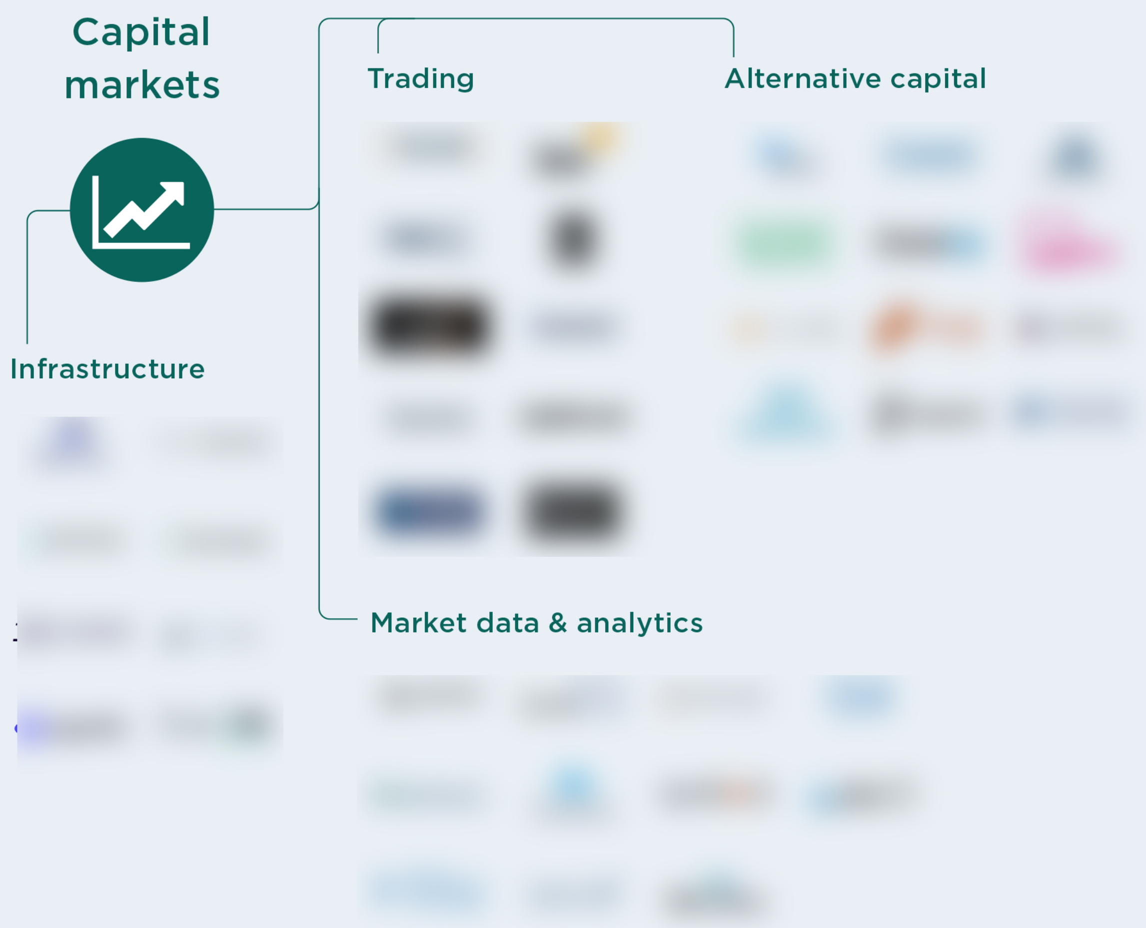
Capital markets

Overview

The capital markets industry primarily consists of large institutional firms that engage in the buying and selling of public equities, private equity, debt, bonds or other securities for businesses, individuals and governments. Functioning capital markets are an important feature of functioning economies, with open-market asset exchange systems tracing their roots back to the earliest days of commerce. The largest stock exchange in the world, the NYSE, has a market cap of $23 trillion dollars, and the US bond market amounts to upward of $40 trillion in asset value.

Participating in capital markets and ensuring they function correctly is a complex undertaking. Traders and investors utilize a byzantine system of global technologies and networks, both private and public, designed to ensure transactions are completed, settled and accounted for in a quick and regulatory-compliant manner. While several market participants rely on innovative technologies—such as high-speed trading systems—to give them an edge, we believe many of today's capital market participants still rely on antiquated technologies and processes that may be slow and prone to error or that lack features and functionality. We believe this aging infrastructure adds to costs, increases regulatory risk and reduces strategic opportunities.

Capital market participants are under increasing pressure to modernize their technology to offset rising competition and macro headwinds. Revenues and ROI among the largest global banks have been stagnant for years as the industry adopts new capital and regulatory requirements. Smaller and more nimble boutique firms are challenging the hegemony of legacy financial institutions for wealth management and advisory business. In addition, automation in bond and equity markets is pressuring fee-based trading businesses and driving more capital to low-fee passive investment strategies.



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Financial services IT

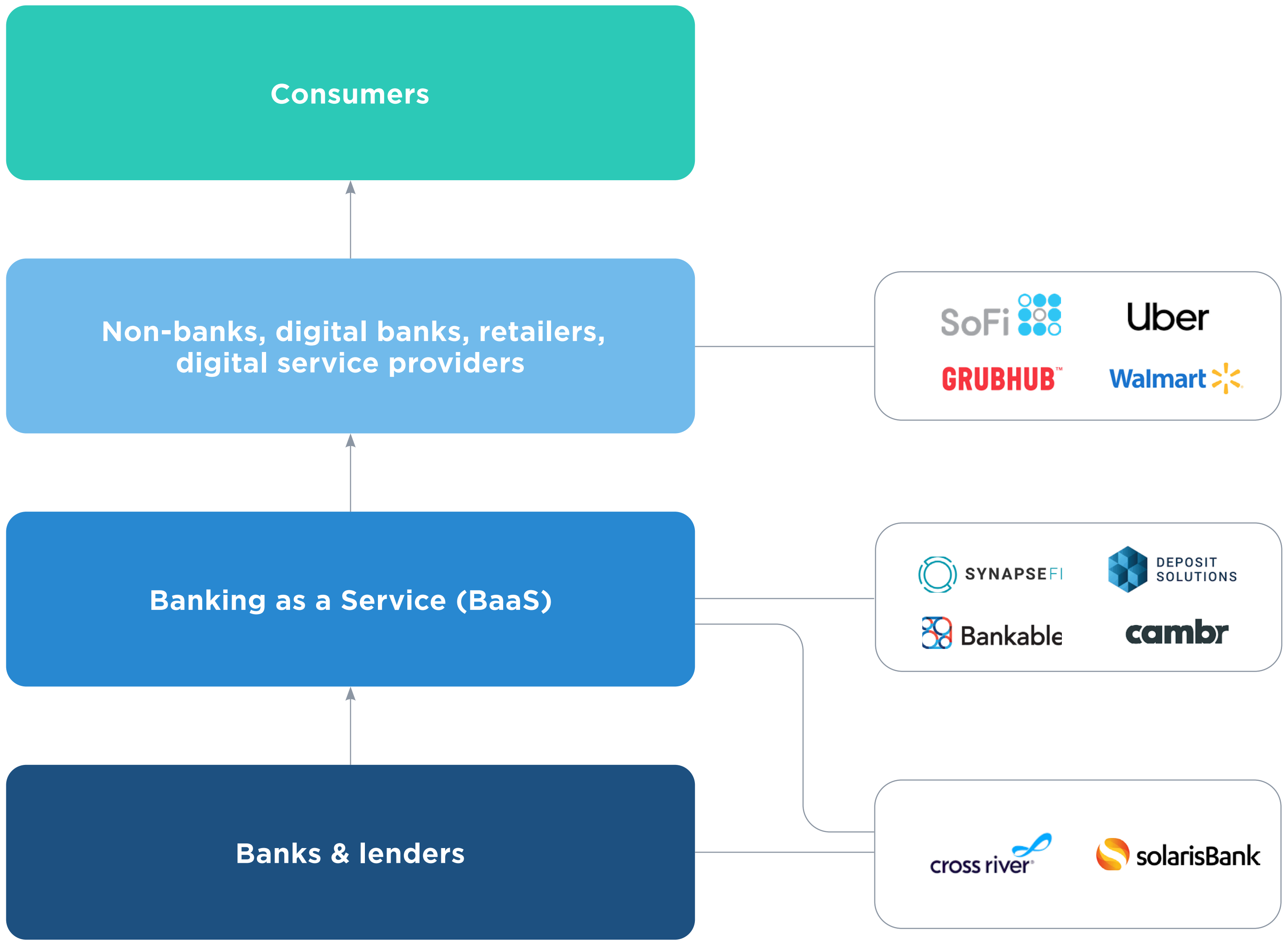
Opportunities

Modernizing the front-, middle- and back-end: Fintech companies focused on IT operations for banks could help sort through the arduous task of categorizing and isolating presentation layers and introducing more automation to reduce costs and drive scale. Providers such as **MX**, Alkami and **nCino** are helping banks modernize its front-end and middleware. These companies offer cloud-based banking platforms to allow banks and other financial institutions to white-label and deploy online signup processes, mobile banking applications, personal finance management and other retail banking services directly to their customers. **nCino**'s product is more robust, offering white-labeled portfolio analytics, treasury management and asset finance and leasing solutions in addition to retail banking solutions.

Core banking: In Capgemini's 2015 Banking Core Modernization survey, 78% of financial institutions agreed that their core banking system will be replaced in the next five years.[10] However, 43% of banking systems and 80% of in-person transactions still use COBOL today.[11] While core banking solutions exist from incumbent providers such as Jack Henry or Fiserv, we believe that startups in this space have an opportunity to deploy more modern offerings for their bank partners. For example, Jack Henry's SilverLake core system requires IBM-powered systems on premise or at Jack Henry's outsourced offering, JHA OutLink Processing Services. This contrasts with **Finxact**'s Core as a Service offering, which is cloud-native, API-based and allows banks to start with a hybrid model of their legacy core system and **Finxact**'s new system. This allows banks to iteratively test the new

Figure 34.

BaaS value chain with select participants



10: Simplifying the Banking Architecture, Capgemini, 2015
11: COBOL blues, TIOBE Index; International Cobol Survey Report; IBM; Microfocus; Celent; Accenture

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Payments

Figure 51.

Notable payments VC deals ($M) by size (last 12 months)

COMPANY	CLOSE DATE	SUBSEGMENT	DEAL SIZE	STAGE	LEAD INVESTOR(S)	VALUATION STEP-UP
toast	February 14, 2020	Payment platform & POS	$400	Series F	TPG Capital, Greenoaks Capital Partners, Bessemer Venture Partners, Tiger Global Management	1.7x
avidxchange	January 17, 2020	AP/AR	$260	Late-stage VC	N/A	N/A
MARQETA	May 21, 2019	B2B payments	$260	Series E	Coatue Management	3.3x
stripe	September 19, 2019	Payment platform & POS	$250	Series G	General Catalyst, Sequoia Capital, Andreessen Horowitz	1.6x
toast	April 19, 2019	Payment platform & POS	$250	Series E	TCV, Tiger Global Management	1.8x

Source: PitchBook

Figure 52.

Notable payments VC exits ($M) by size (last 12 months)

COMPANY	CLOSE DATE	SUBSEGMENT	EXIT SIZE	ACQUIRER/INDEX	VALUATION STEP-UP	VALUATION METRIC
Bill.com	December 12, 2019	AP/AR	$1,336	NYSE: BILL	1.3x	16.1x EV/rev
InstaMed	July 24, 2019	Payment platform & POS	$600	JPMorgan Chase	2.4x	N/A
wave	June 10, 2019	AP/AR	$405	H&R Block	N/A	N/A
wibmo	April 12, 2019	Payment platform & POS	$70	PayU	N/A	N/A
optile	December 10, 2019	Payment platform & POS	$56	**Payoneer**	N/A	N/A

Source: PitchBook

