ROSENBLATT SECURITIES

Investment Banking – FinTech Viewpoint

August 2020

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A Reality Check on FinTech During COVID-19

Key Developments, Trends and Notable Deals in Six FinTech Sub-sectors

Private FinTech In The Time Of COVID-19

Top Funding Rounds In 2020

Company	Deal Value	Company	Deal Value
stripe	$600 M	bakkt	$300 M
robinhood	$600 M	UiPath	$225 M
toast	$400 M	Revolut	$200 M
avidxchange	$388 M	TransferWise	$200 M

IPOs In 2020

Company	Valuation	Expected
Lemonade	$3,800 M	coinbase
SelectQuote	$3,300 M	robinhood
ncino	$3,000 M	蚂蚁金服 Ant Financial
Shift4 Payments	$1,600 M	

Major M&A Transactions

Company	Acquirer	Valuation	Target	Acquirer	Valuation
E*TRADE	Morgan Stanley	$13,000 M	Galileo	SoFi	$1,200 M
credit karma	intuit	$7,100 M	Finicity	mastercard	$1,000 M
PLAID	VISA	$5,300 M	personal capital	Empower Retirement	$1,000 M
CardWorks	ally	$2,700 M			

Source: Rosenblatt analysis, Capital IQ, Bloomberg, PitchBook

What a difference two quarters can make. At February-end, FinTech funding was at an all-time high, M&A activity was robust, and there were at least 8 FinTech unicorns expected to go public in 2020. By April end, it seemed like the wheels were going to come off the FinTech bandwagon. Funding slowed down to the lowest levels in 4 years, M&A ground to a halt and high-flying firms like Motif closed shop for good. But six months into the COVID crisis and with public markets hitting an all-time high, the private FinTech market seems to have navigated the crisis quite well, all things considered. Funding is recovering, so is M&A, and there are 5 Unicorns preparing to go public in the next six months. It's important to take stock of the FinTech market, do a deep dive into how different sub-sectors are doing, analyze funding activity and M&A deals, and consider what's ahead in each sector.

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Rosenblatt employs the following framework to analyze the implications of COVID-19 on private FinTechs:

- How business conditions (both demand and supply) have changed and their impact on a FinTech sector's operating performance
- Changes to funding conditions, and their effect on growth plans
- Shifts in exit options (M&A, IPOs) and if investors have altered their investment timeframes.

Wealth Management: Resurgence in retail trading during COVID saves the day

- A steep decline in public markets (like March 2020) usually scares away retail investors and crimps growth in wealth management. But despite record volatility, retail investors aren't afraid of entering the markets, and we have seen record levels of retail trading fueled by people staying at home and the proliferation of free trading platforms led by Robinhood. (The firm has become the poster child for this growth, with valuation doubling over the last year to $13.2 billion and plans to go public in Q4 2020).
- But beyond robust growth in retail trading platforms, the robo advisor segment is performing just about average. The demise of Motif, a leading robo advisor and brokerage firm with 300,000 customers, $868 million in assets and Goldman Sachs as an investor and distributor of its products, has somewhat shaken investor confidence in this market segment. Pure play robo advisers (e.g., Betterment, WealthFront) that have been leading this segment in the last few years are being threatened by two sets of firms. Diversified FinTechs that began in another segment and over time have begun rebundling robo advisory services (Acorns, Stash, Blooom, SoFi) are catching up fast and becoming serious players. Secondly, incumbent financial institutions (Fidelity Investments, Morgan Stanley, VanGuard) are quickly narrowing the digital gap between their offerings and leading robo advisers. COVID-19 and the ensuing economic environment has hastened the loss of leader status for pure-play robo advisers. As this begins to happen, investors may constrict funding or accord lower valuations to these types of firms.
- **Notable deals:** Like other FinTech sectors, M&A deal volume for wealth management in Q2 declined 25% over Q1 and 35% over Q4 2019. The blockbuster retail brokerage deal was Morgan Stanley's acquisition of ETrade in April for $13 billion, partly in response to Schwab buying TD Ameritrade for $26 billion in Nov 2019. In robo advisor land, Goldman Sachs purchased the RIA custodian Folio in May 2020 for an estimated $250 million, Personal Capital was acquired by Empower Financial for $1 billion in July, and Franklin Templeton bought Advisor Engine for an undisclosed sum in May. Motif's assets were divided between Goldman and Schwab, with the former buying the assets and client book while it's IP and headcount went to the latter.

Digital Lending: In a tight squeeze

- Before the COVID crisis, digital lenders were doing well and flexing their muscles with LendingClub acquiring Radius Bank in Feb 2020, the first time a FinTech acquired a traditional bank. But the wheels have quickly come off the digital lending space since then. Lending businesses tend to do badly in weak economic times, and this year has been no exception. However, delinquency rates at big digital lending platforms (Best Egg, Lending Club, Upstart, SoFI) are better than the worst that was expected in Spring. According to dv01, delinquency rates were 6% before the crisis, peaked at 16% in April and recovered to 9.7% in August. But as

COVID wears on and government stimulus expires, default rates may rise, hurting digital lenders. The stock price of public firms like Lending Club - down 56% since the crisis began – maybe an indication for tougher times to come for digital lenders.

- Digital lenders played a critical role in disbursing Paycheck Protection Program (PPP) loans with firms like Kabbage becoming the 4th largest lender in the program. They offered faster payment, greater convenience, and more flexible options to SMBs looking for PPP loans than traditional banks which got backlogged. Other digital lenders were Credibly, Funding Circle, Lendio, Intuit QuickBooks, OnDeck and PayPal.
- The one bright spot in this segment has been loan servicing and debt collection where FinTechs are enjoying growth and attracting funding, as lending conditions worsen and banks try to manage the fall-out. Top areas have been student debt management (notable firms are Pillar, Summer and FutureFuel), receivables management (Crosslend, Collbox and Scratch), and 3rd party debt collection (Trov, Debtsy, TrueAccord).
- **Notable deals:** Pressure on digital lenders is evident by former high-flyers like Kabbage halting lending and selling out to American Express, and OnDeck Capital selling out to Enova for $90 million (at a mere $1.38 per share). On the funding side, money is flowing into debt collection and loan management, though FinTechs in this space are smaller and at an earlier stage of growth. TrueAccord raised a $36 million Series C round at a $78 million valuation and is being followed by a lot of other players in this sector raising capital.

InsurTech: Spared from the worst, and enjoying a resurgence in demand

- Usually, calamities like COVID-19 spell awful news for the insurance industry leading to massive claims that hurt the sector for many years. Life and health insurers are definitely bearing the brunt of multibillion-dollar claims and facing lawsuits. But because most P&C insurers had pandemic exclusions, they are mainly off the hook to pay for massive COVID-19 related claims. With the shutdown limiting the movement of insurance brokers and agents, there has been a big push towards digital-only brokers helping firms like Lemonade grow and go public at healthy valuations. So, it's a mixed picture for the insurance industry.
- The virus has boosted demand for life, health, and business disruption coverage as people have greater sensitivity to risk and insurance coverage. Enormous growth in online transactions has created massive fraud, identity theft, and cybersecurity risks that InsurTechs like Arceo, CyberCube, and Deep Labs are trying to address by context-aware computing and advanced analytics.
- COVID-19 has led to an increased focus on covering emerging and unconventional risks (cybersecurity, climate change, social disruption) due to heightened awareness of black swan events like COVID-19. Rosenblatt's 12th FinTech Summit had a panel discussion on this topic with 5 leading InsurTechs we showcased that cover emerging risks: Arceo, Bold Penguin, Deep Labs, Risk Genius and Thimble. InsurTechs are tackling emerging risks like pandemics in different ways. Firms like Risk Genius help insurers assess what their real exposure to pandemics and infectious diseases is, while Praedicat also does that and is pioneering novel ways for insurers to cover pandemics.
- **Notable deals:** More InsurTechs have gone public this year than any other FinTech segment, with most new issues performing very well post IPO. Besides Lemonade going public, SaaS vendor Duck Creek raised $405 million and rose 48% on its trading debut, Select Quote went

public in May raising $360 million and is trading at its IPO price after having appreciated 50% at one point over its opening price. Health insurance marketplace GoHealth raised $913 million in its IPO and is the sole InsurTech this year trading below its IPO price. On the IPO on-ramp are InsurTechs like China-based Lu.com, expected to go public in Q4 2020 and India-based Policy Bazaar with plans to file a dual-listed IPO in Q2 2021.

Capital Markets: Feasting time, for now

- The capital markets business is used to alternating between feast or famine, depending on market levels and volatility. Traditional capital markets firms (institutional brokers, exchanges, clearing firms) have greatly benefitted from high volatility, massive retail trading volume, and heightened institutional trading, making this sector one of the few bright spots in an otherwise gloomy FinTech market in Q2/Q3. Shares for market makers like Virtu have hit all-time highs, with Q2 revenue up 139% year over year. But volatility has reduced and transaction volumes are coming down from their peaks which will may slow the growth enjoyed by institutional firms through COVID times. (According to Rosenblatt's market structure group, average daily volume for equity trades was 9.23 billion in August, a 12% decline over July).
- The capital markets industry has been led by retail activity in Q2/Q3. For the first time in a decade, institutional activity has been overshadowed by retail traders/investors with 25% of US equity trading volume contributed by individuals (the past 5-year average has been 8-10%). But retail traders are fickle and their trading volumes can quickly subside in the Fall as market conditions change.
- FinTechs providing trading infrastructure have benefited from market volatility with greater demand from institutional clients (buy-side firms, broker/dealers) who have fared well through the sharp market recovery. But Alternate Data FinTechs have experienced slower growth as institutional investors have become conservative and gravitated towards traditional investment methodology and practices. Capital markets FinTechs focused on better managing risk, lowering costs, and facilitating remote work (hosting solutions, cyber security, Cloud-based delivery) have also done well. Investors will double down on these investments going forward.
- One growth area has been FinTechs focused on improving liquidity and transparency of alternative assets and technology that democratizes access to investing. Our 12th FinTech banking conference showcased five leading firms in this area: AltoIRA, Capitolis, Clearlist, T-Rex, and YieldStreet. Click here for a recording of the discussion and a report about the panel. Another related issue is a growth in demand on platforms that enable the trading of private securities: Major players are Addeppar, Carta, Equity Zen, Forge Global, Nasdaq Private Markets and Zanbato.
- **Notable deals:** Capital markets has lagged other FinTech verticals in M&A transaction volume, and funding has slowed down though there were 8 mega funding rounds in Q1/Q2 2020. Collibra raised a $112 million Series D round, Payfone raised $100 million, while Carta raised $210 million for its Series E. There are several capital markets Unicorns well positioned to go public over the 3-6 months: Coinbase, Carta, Circle Financial, TradeShift and Symphony.

Challenger Banks: Some of the shine wears off

- Declining business activity, a weakening economy, and tight funding conditions have hurt Challenger banks. The Fed's near-zero rate has crimped Net Interest Margins (NIM) and margins have gotten even more compressed than traditional banks as the former rely much more heavily on transaction revenues, which has declined amidst COVID-19.
- The cost of funding for Challenger banks has not reduced proportionately to lower Fed rates, and less than that for incumbent banks, weakening their competitive position. Consequently, new account opening has slowed down, especially the steady flow of millennials opening new accounts which has been a big driver for funding and valuation growth for Challenger banks.
- The one positive driver has been higher digital usage by customers over brick and mortar channels, a much-needed tailwind for this sector benefiting digital banks over traditional players like Bank of America, Citi and Wells Fargo. Several challenger banks (like Chime) very smartly positioned themselves to disburse government funds digitally to consumers and businesses, greatly benefitting their growth and brand recognition.
- **Notable deals:** Not all banks have faired equally this year through the COVID crisis and the gap between leaders and laggards has widened when it comes to customer adoption, growth rates, and even funding. A number of banks have suffered from declining customer acquisition, which has always been a major source of growth for challenger banks. But leaders like Revolut have continued to close funding rounds ($580 million/Series D) and are scouting for acquisitions in the travel space. Varo closed a $241 million Series D round in June. The challenger bank model has been most successful in the UK, and leading firms (Aspiration, N26 and Starling) have been raising sizable rounds of capital through the COVID crisis.

Payments: The one bright spot in FinTech during COVID

- Payment FinTechs have been one of the few bright spots during COVID times. While a paralyzed global economy has curtailed overall consumption and reduced transactions, the shift to digital payments has significantly benefitted payment FinTechs. Square and Stripe are poster-children for growth in this segment. Square's stock price has gone up 166% YTD while Stripe raised $600 million in May at a $36 billion valuation on the back of record growth for its platform. Square has built a powerful platform that bridges the gap between consumers (via the enormously successful Cash app) and merchants, creating a strong network effect that boosts transactions on its platform. Stripe's Atlas platform that provides a launchpad for new businesses, grew 220% between Dec 2019-April 2020. So, prospects for the payments sector have remained positive despite economic headwinds and the COVID shutdown.
- One area that is growing unabated is the embedding of payments by both financial and non-financial companies and growing demand for technology vendors like Finix that enable the embedding of payments. This is a core area that the Rosenblatt banking group covers; see our research describing this critical trend, and a panel discussion at our 12th FinTech summit showcasing companies enabling the embedding of lending, payments, insurance and investments.
- **Notable deals:** After the hectic consolidation in Payments in 2019 (three big mergers: Fiserv/First Data, FIS/World Pay, Global Payments/Thsys), which was a defensive play by incumbents to drive economies of scale, the biggest deals in FinTech have taken place in

Payments. Visa acquired Plaid in January for $5.3 billion (at 2x its last round valuation) followed by MasterCard buying Finicity for $1 billion in June, attempts by the large payments networks to remain relevant in the digital payments space and to serve the new crop of digital-first businesses. Sofi bought Galileo in April for $1.2 billion to diversify further outside student loans. On the funding side, embedded payments like Finix continue to attract solid investor interest closing their Series B round for $30 million. Looking ahead, the most anticipated deal is ANTFinancial's impending IPO in Q4 2020 to raise $30 billion, which will be a dual listing in Hong Kong/Shanghai.

Concluding Thoughts

The FinTech market has handled the COVID decline quite well and despite softness in overall funding and M&A transactions, there are still 66 Unicorns left standing valued at $248 billion, up from 58 firms in 2019 valued at $213 billion. At least 10 of these firms have announced plans to go public in the next year including Robinhood, Policy Bazaar, Coinbase and Stripe. Going one level deeper, there are major differences and nuances in how different FinTech sub-sectors have performed and their prospects for the future. Digital lenders are suffering the biggest drop (lower valuations, slower funding), followed by softness in the ranks of Challenger banks. Capital markets FinTechs are enjoying record trading volumes but there is trepidation of what's to come next. Payment FinTechs have also done very well with record growth in ecommerce and robust demand for technology that enables embedded payments. The Insurance industry has definitely been plagued by high claims but the blow has been softened by growing demand for new policies due to heightened risk sensitivity, with particular demand for covering emerging and unconventional risks. Wealth management has stayed afloat on the back of record retail trading activity. But there are threats to pureplay robo advisors from incumbent wealth providers catching up and broader FinTechs that are aggressively rebundling wealth capability to their offerings.

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