ROSENBLATT SECURITIES

Investment Banking – FinTech Viewpoint

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Analyzing FinTech's Brilliant Growth in 2021, and Looking Towards 2022

A Landmark Year, But A Shifting Landscape

This Viewpoint has two objectives: 1) to capture FinTech events in 2021 across six verticals, and 2) to look behind the headlines and identify underlying trends that will drive activity into 2022. For a more comprehensive take on these trends, listen to the recording of a webinar we hosted last December.

2021: A Banner Year for Private FinTech, But a Rude Awakening in the Public Market

2021 was a banner year for FinTech, borne out by record private-market funding, the dollar value of M&A done, and the number of IPOs and SPACs completed. An estimated $135Bill in private capital was invested in private FinTechs compared to $44Bill in 2020, a 206% YoY growth. 4,320 deals were done in 2022 compared to 2,972 in 2021. Median step-up in valuation rose YoY from 1.6x to 2.3x. FinTech Unicorns grew by leaps and bounds, with 60% of all Unicorns (208) that existed at year-end 2021 having reached that milestone last year.

The M&A market was hot in 2021, and we expect the momentum to continue in 2022. An interesting trend was FinTechs acquiring one another, major examples being Square/Afterpay, PayPal/Paidy, PayU/BillDesk, Galaxy Digital/BitGo, Visa/CurrencyCloud, and Lemonade/Metromile.

2021 was a massive year for US IPOs, doubling from 190 in 2020 to 388 in 2021. $138Bill of capital was raised through IPOs, compared to $78Bill in 2020. 16 FinTechs went public with Affirm, Coinbase, and Robinhood standing out due to their enormous size. But the mood turns sanguine looking at the performance of newly public FinTechs in 2021 (including IPOs, Direct Auctions, and SPACs) that experienced much investor wrath. Apart from Crypto, BNPL, and a lone wolf, like SoFi in the challenger bank space, all the other FinTechs that went public in 2021 ended the year down 30-40% over their IPO price. Most notable are companies that merged with SPACs to go public that began the year with a bang but severely underperformed in the second half of 2021. 14 FinTechs completed SPAC mergers and began trading. 2H2021 saw a rationalization of the SPAC phenomenon, with investor redemptions rising to more than 80% in some cases and PIPE capital becoming critical for a SPAC to succeed.

All this activity in the public markets raises critical questions going into 2022:

1. Have the private markets accorded FinTechs much higher multiples compared to public market investors?
2. Will a severe contraction in the public market stock multiples work back into the private market? If so, how quickly?
3. How will the tough reception given to new IPOs impact Unicorns on the IPO on-ramp?
4. Does the SPAC model still work in the face of the 2021 cohort that debuted in public markets but has languished severely, with most down a whopping 40-70% since their launch? Will FinTechs hoping to SPAC-out change course and cancel plans (like Acorns did this week?)
5. Will there be adequate targets available for SPACs to merge with?
6. Who will cover research on all the smaller SPACs going public?

Let us now examine key trends that drove activity across six FinTech sectors in 2021 and will carry the momentum into 2022.

Challenger Banks (CBs) Evolve, Entering a Much More Competitive Segment

CBs entered their next phase of growth in 2021, evolving from B2C models focused on "unbanked, under-banked" customer segments, to serving near-prime and prime customer segments where the competition is much more intense. CBs have succeeded thus far by addressing the shortcomings of traditional banks (high fees/spreads, conflicts of interest, weak service) and by doing innovative things: helping people build/improve credit history with "credit-builder" loans, pay-day loans, advance COVID payments, etc. But competition with traditional banks, and among CBs is heating up, and it is getting much tougher to differentiate. Incumbent firms are also addressing consumer pain points like Capital One eliminating all consumer overdraft fees. (Is this a "Robinhood moment" for the Banking industry?)

Going into 2022, CBs will face three issues: 1) how do they differentiate themselves in a market where the core offerings are increasingly commoditized? 2) how to acquire customers in the face of stricter privacy requirements and rising CAC, and 3) how well does this model perform as rates rise?

A final development to note is the evolution of new-age "Community Banks", serving niche customer segments, and "affinity groups" catering to LBGTQ, African Americans, or incarcerated people. Examples of such banks include Aspiration, Current, Daylight, Greenlight, Happy Money Step, etc.

Digital Lending Matures with BNPL Being Its Brightest Light

BNPL was the hottest sector in Digital Lending, the sole unsecured-lending asset class with high double-digit growth during the pandemic, and the second most active deal-making sector after Crypto. There were big M&A deals (Square buying AfterPay for $29Billion), major partnerships (Affirm/Amazon), and firms expanding offerings (ApplePay and Paypal). Having become the preferred choice to finance purchases among Millennials and GenZeers, BNPL has rapidly grown in 2020/2021, with more room to grow as it encroaches into the credit card space, albeit this may happen slowly. M&A activity in 2021 strongly reflects this sector's vibrance and will continue in 2022, with traditional firms targeting the remaining independent providers in a land grab. Critics may question the jaw-dropping $29 billion price that Square paid for AfterPay, but there is strong justification, as explained in our Viewpoint. One criticism about BNPL is that it could be driving unbridled consumption, with

people buying goods they don't need but attracted by lucrative, no-interest offers. There is also concern about delinquency rates as rates rise or if the economy softens.

Payments 3.0 is Here With Programmable Money

Payments are evolving into their next phase of growth: 3.0, which will be characterized by programmable money and the use of Stablecoins. First-generation payment services (1.0) began in 2001 with eCommerce payment providers like Paypal, P2P payment firms like Venmo (now a part of Paypal), international remittance providers like Xoom (acquired by Paypal) and Remitly/Wise (formerly Transferwise) emerging during this time. By 2018, we evolved into Payments 2.0 with ride-sharing firms pioneering the concept of embedded payments, which is spreading to every vertical sector from restaurants to property management. The next phase of Payment evolution (3.0) will be DeFi payments using programmable money that allows restrictions to be placed on the timing and purpose of how money is used and making money real-time, frictionless, and ubiquitous. This was simply impossible with cash or digitized currency. CBDCs may also play a significant role in defining this next stage of money and payments, with China poised to lead this race.

Capital Markets Becomes A Key Testing Ground for Blockchain Usage

Our long-term thesis in Capital Markets is that the entire process of capital formation, investing, trading, clearing and settlement, and custody will not only go fully digital, but parts of it will get decentralized in the next few years. But for this to happen, new Blockchain-based infrastructure needs to be built, which began in earnest last year and will continue in 2022. Some of the biggest funding rounds in all of FinTech were in this area, including firms like Anchorage, Circle, FalconX, Fireblocks, FTX, and Paxos. See our recent Viewpoint analyzing Crypto deals in 2021 and Rosenblatt's 13th FinTech Summit in May 2021, which showcased 16 CEOs that are building this infrastructure.

Another major trend in 2021 was greater institutional adoption of digital assets, mostly cryptocurrencies but an eventual expansion into USDCs and other tokenized assets. Coinbase's IPO with its market cap hitting $80 Billion was a watershed moment and a shot across the bow of traditional exchanges like NYSE, Nasdaq, and LSE. As Coinbase and other crypto exchanges expand their institutional offerings, it begs the question: will securities get tokenized one day and start trading on digital exchanges? Will this disrupt traditional exchanges and service providers?

Wealth Management Experienced A Retail Resurgence, Driven By the Reddit Crowd

2021's top trend in this sector was a dramatic increase in the participation of retail investors across equities, options, and Cryptocurrencies. The power of the "Reddit crowd" to assemble *en masse* and challenge the "short hedge fund crowd" became major news, with retail investors contributing 33% of US equity trading volume at one point. Retail trading also drove up volatility forcing brokers like Robinhood to raise large sums of money overnight to meet higher collateral requirements imposed by DTCC. The price activity in meme stocks drove widespread claims of manipulation in US equity trading, with the SEC examining this issue carefully but falling short of laying blame on any market participant.

The 2nd major trend was ESG becoming a top issue for consumers. New platforms are emerging to accommodate investor needs, including market data and indices for ESG factors, search tools that sift for climate change or governance, and dedicated investment platforms for these products.

Another trend that gained traction was greater automation of private markets to improve access, liquidity, transparency, efficiency, and compliance. Functions that are being targeted include fundraising and issuance, execution, and full front-to-back automation of the entire workflow for private securities. Major platforms operating private security trading are CartaX, ClearList, EquityZen, Forge, Nasdaq Private Markets, and Zanbato. There are also companies like DealMaker that automate and improve issuance for smaller issuers, enabling more convenient, cost-effective, and secure payments.

InsurTechs and New Technology Continue to Transform This Once-Staid Business

2021 saw the continued transformation of the insurance business driven by new technology and innovative InsurTechs that are causing a reallocation of premium pools, the redistribution of power and profits, and disaggregation of the insurance value chain. New technologies like IoT/Autonomous Driving/AI-ML/Blockchain have redefined risk and redrawn boundaries in key areas, including Climate change, Cybersecurity, Gig economy, and the "Work from Home" economy.

The last two years have taught us a crucial lesson to take unconventional risks (like pandemics) seriously and exposed us to the massive downstream implications of new risks like climate change, aging populations, and technological disruption. This is thrusting insurers into new roles: moving beyond basic reimbursement for damages to giving incentives for better detection and prevention so covered parties can detect new risks quickly and address them before they fully materialize.

Finally, new InsurTech models (on-demand, embedded, parametric insurance) continued to grow. On-Demand insurance is growing quickly due to demographic shifts, usage-based models, and emerging technologies like AI/ML, and IoT. Embedded insurance (e.g. PoS insurance) is driven by firms like Tesla that have extended auto insurance across more US States, thus redrawing traditional battle lines in Insurance (we highlighted this in our Jan 2021 Top Trends webinar). The third interesting model is Parametric insurance led by firms like Blink that give pre-specified payouts triggered by a particular event.

Conclusion: Peering into the FinTech Crystal Ball Going into 2022

2021 was a record-breaking year for FinTech, and this Viewpoint described crucial trends behind this activity across six sectors. Looking towards 2022, here are five key issues to watch for:

- Inflation fears have caused a rerating of the entire Tech sector, with public market FinTechs rerated as well. We expect investors to become more discerning in 2022, with valuations getting more rationalized in favor of proven companies that will receive premium multiples
- The overall FinTech value proposition of delivering products transparently, inexpensively, on-demand, and with better UI/UX remains solidly intact. FinTechs with lower CACs, an ability to

capture higher Life Time Value (LTV), and who can manage risk prudently will break away from marginal players

- DeFi and Embedded Finance are two areas with the biggest promise that will drive growth in 2022 and beyond. Both areas promise to be multitrillion-dollar opportunities in the next few years and will receive the largest allocation of private and public market capital
- Incumbents will upgrade offerings, lower fees and improve user experience. They will also target the public market FinTechs (that are now more affordable) for their technology, marketing-savvy, customer base, and management. We also expect consolidation within FinTechs to fill product, geographic, or capability gaps.
- Finally, the themes of fairness, financial inclusion, and ESG will remain key priorities for customers and investors, driving investment dollars, product offerings, and new platforms that serve these priorities.

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