MOORE Kingston Smith

INVESTMENT IN FINTECH SECTOR INCREASES AGAINST BACKDROP OF UNCERTAINTY

A review of Q2 2020 growth capital investment in the fintech sector

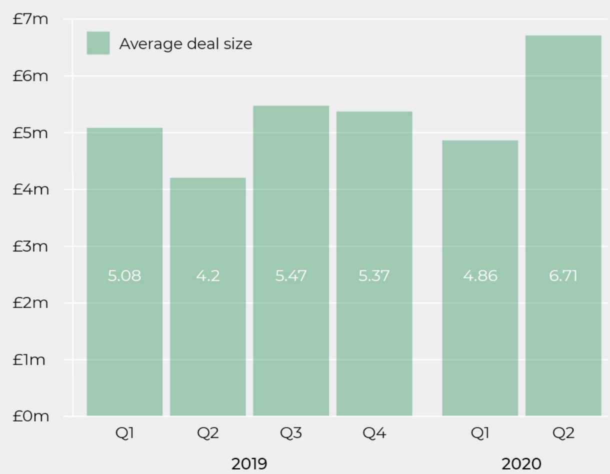
According to our research into UK private companies raising between £1 million and £20 million each of growth equity capital, 161 British businesses raised £779 million of growth capital in the second quarter of 2020. The Q2 figures for the overall growth capital market illustrated a 10% - 15% quarter-on-quarter decline in the number of deals completing and the amount of growth capital being raised. This is not surprising, given that the UK was in lockdown because of Coronavirus for most of this period.

The fintech sector has performed significantly better than the wider growth capital market in Q2 2020 and has actually seen quarter-on-quarter growth. In Q2, 34 fintech deals completed, raising an aggregate £228 million, compared with 30 deals and £146 million in Q1. Fintech deals make up 21% of all growth capital deals completed and account for 29% of funds raised. This demonstrates that the tech behind Britain's financial services industries is becoming even more popular with growth capital investors. One reason for the increase in interest is that, for many banks and other businesses, fintech is proving to be a solution to the challenges brought by the Coronavirus crisis.

FINTECH SECTOR DEAL VOLUME AND AS A PERCENTAGE OF TOTAL DEALS

The average deal size in Q2 2020 was £6.71 million, which is a huge 38% increase on Q1's £4.86 million, and considerably higher than the corresponding figures for any quarter in 2019.

AVERAGE DEAL SIZE IN THE FINTECH SECTOR (£M)



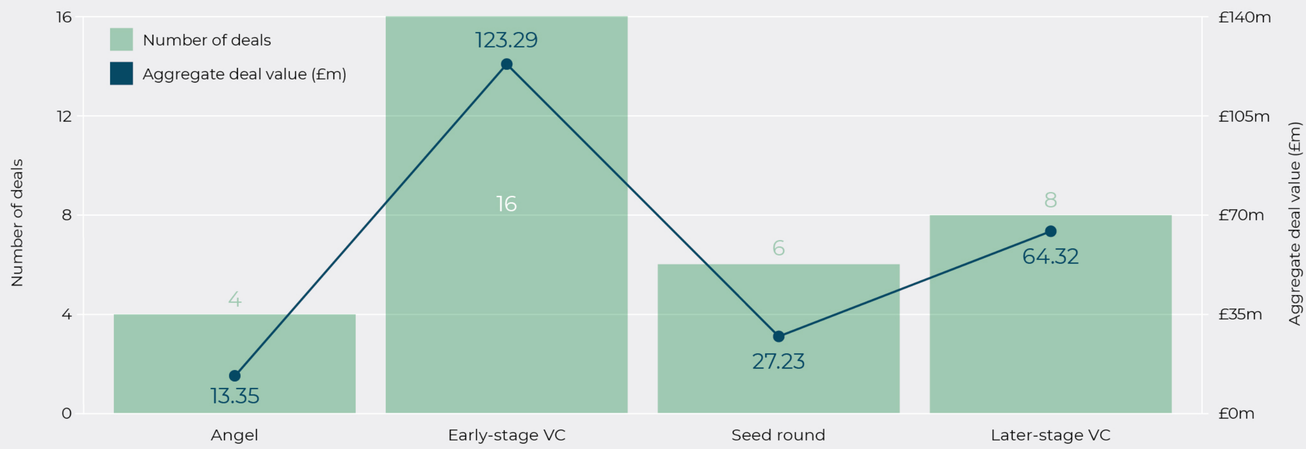
"Lockdown and social distancing measures have not stopped the growth of the UK's fintech industry," says Ryan Day, Partner. "Traditional banks have had no choice but to scale back their retail operations and push customers towards digital platforms. Landlords and buyers opted for digital solutions to the closed high street estate agents and even conservative investors are looking to spread the risk of their portfolio by utilising tech."

Day continues: "However, that doesn't mean the funding gap hasn't been significant for the fintech sector. The need to raise equity in the current climate has never been so great with PE houses and venture capitalists looking for their investments to reduce burn rate and focus on revenue generation. We expect many fintechs to make use of government-backed support such as the Future Fund, which provides loans of up to £5 million in matched funding for further growth."

Regarding the types of fintech investment deals that were most common in Q2 2020, early-stage VC accounted for almost half the deals completed, with later-stage VC rounds coming second, and seed rounds third.

62% of all growth capital deals recorded in Q2 2020 involved companies headquartered in the Greater London area. This percentage increases to 91% when we look at fintech deals in isolation, which is not surprising given London's status as the UK's financial services capital.

FINTECH SECTOR DEAL VOLUME AND VALUE BY INVESTOR TYPE



RAISING GROWTH CAPITAL DURING A PANDEMIC

Aaron Townsend, Head of Finance at Habito, an online mortgage broker and lender, tells us about his experience of managing a business during a pandemic, including closing a £35 million funding round.

"The level of uncertainty caused by the Coronavirus and the speed at which the environment was changing forced us to act quickly. The lockdown completely shut down the property purchase market and, as a result, our brokerage business line lost all activities related to first-time and next-time buyers. We were, however, able to focus on remortgages and saw great success. We estimate that our share of the remortgage market increased by 50% during the pandemic. Being fully digital but also free gave us a real advantage.

While we were able to weather the storm, we did see a drop in our revenues over the last few months. We had to make changes to our operating expenses by reducing our cash flow and managing our payables very closely. We also made use of the government schemes such as CJRS, PAYE deferrals and the Future Fund.

Fundraising conditions have been suboptimal over the last few months with investors retrenching from the start-up sector. For some companies, this could have been the difference between survival and administration. By demonstrating our strong fundamentals, future growth and good expense management, along with a recognisable brand and continued support from our existing investors, we were able get fundraising over the line. Habito closed a £35 million fundraising round in July with new investors such as Augmentum Fintech, SBI Group and Mojo capital and with continued support from Atomico Ventures, Mosaic Ventures, Ribbit Capital and DST Global Investments Limited.

We're now able to assist buyers again and our revenues are almost back to pre-Coronavirus levels. Demand for our products has returned and our brokerage line is performing at its historic best. This is despite a reduction in the number of mortgages available for those with deposits of 5% and 10%. While the base rate is at its lowest ever, this hasn't always been reflected in the mortgage products, however, they're still low compared to financial crisis levels.

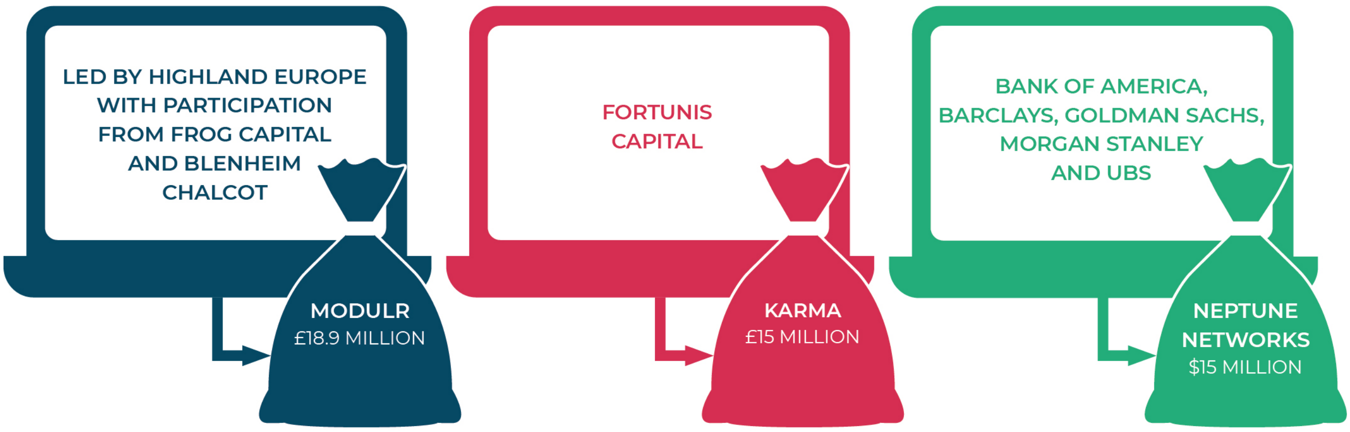
Habito remains cautiously optimistic about the future. In the event of a second lockdown, our technology and continued focus on our product will enable us to continue to serve our customers."

NOTABLE DEALS

In May 2020, Modulr, a UK payments-as-a-service API platform for digital businesses, announced that it had raised £18.9 million in a funding round led by Highland Europe, with participation from Frog Capital and Blenheim Chalcot. In its four years since being founded, Modulr has established itself as a digital alternative to traditional banks in the wholesale and transaction payments market, which moves $120 trillion each year. Modulr is specifically targeting the $2.7 trillion incurred through administrative costs, 80% of which is paid by small businesses relying on legacy banking infrastructure. This latest funding round will be used by Modulr to push into new products and services, beginning with card issuing, as well as an expansion into new markets.

Also in May, Fortunis Capital announced that it had invested £15 million in UK-based voucher platform Karma, which has held trials of an app aimed at disrupting the payday loans market. Employers signing up to Karma can advance staff up to £300 on their salary to purchase goods and services at retailers. Employees pay no interest or fees on the amounts advanced. Karma has also been supported by the Financial Conduct Authority's sandbox programme, which allows new innovative products to be tested with real consumers within a controlled regulatory framework.

In June, fixed income pre-trade market utility provider Neptune Networks confirmed that it had closed a $15 million capital raise from existing shareholders including Bank of America, Barclays, Goldman Sachs, Morgan Stanley and UBS. According to the company, the funding will be utilised to further its growth in technology and data as well as the overall business structure. It will also enhance its client coverage in the US and strengthen its network.



FUNDRAISING DURING CORONAVIRUS: AN ENTREPRENEUR'S PERSPECTIVE

Dylan Bourguignon, CEO of award-winning SO-SURE says: "The headlines of funding in insurtech or fintech are often deceptive. You have to bear in mind that investment is often measured by averages as opposed to median, which can lead to a few large transactions dwarfing others. While it's true UK insurtech and fintech sectors have received increasing amounts of funding in recent years, insurtech still remains underfunded.

For all sectors, the pandemic has made fundraising more difficult. While the investment announcements in March to June are likely to have been signed pre-Coronavirus, entrepreneurs who were mid-process or starting to go to market have found funding harder than usual since mid-March. Many investment funds froze new investments to focus on their portfolio or waited to see how companies would trade in the new 'normal'. Others moved their investment strategy away from B2C businesses in expectation of a recession. Some, but far fewer than normal, did continue investing as before. The government's Future Fund was therefore required to ensure that the many great businesses that would have been funded in normal times could continue growing and employing people during this period of funding dislocation.

As with every tunnel, there is light at the end. It would appear that investors are returning to market and founders' efforts to restructure or pivot over the past months will bear fruit in the continued uncertainty. We are living in exceptional times where the future is hard to predict. However, founders are resilient and nimble organisations will find their way to success."

OUTLOOK

The UK's growth capital market has shrunk in the first half of 2020. We are not at all surprised to see this reduction in general activity, given that the UK was in lockdown because of Coronavirus for most of this period.

What may be more surprising is that against that backdrop, deal-doing in the UK's fintech sector has actually increased, with Q2 2020 representing an all-time high for the amount of money raised by the sector. This is testament to the resilience and optimism of the UK's fintech scene.

Paul Winterflood, Corporate Finance Director, says: "London is a world leader in fintech innovation and UK-based institutions are actively looking for investment opportunities, despite the economic backdrop. I expect this level of investment activity to continue in the second half of the year."

CONTACT US

If you're looking to scale your fintech business and it has revenues of at least £1 million, get in touch for an initial discussion. We can work together to assess the best action and assist with finding the right funding partner.

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AN INVESTOR'S PERSPECTIVE

"AlbionVC continues to look for the same key attributes when assessing investment opportunities: the experience and vision of the team, a strong value proposition for customers, the differentiation versus competitors and the long-term defensibility. We are also looking for continued growth and traction throughout Coronavirus, which can be evidence of potential countercyclical qualities. Various fintech start-ups are indeed benefiting from the acceleration of digitalisation. AlbionVC completed two new fintech deals in Q2 2020 with our investments in Credit Kudos and TransFICC. Credit Kudos is a challenger credit bureau automating and optimising the application and scoring of consumer credit by leveraging open banking and machine learning. The current crisis is making their solution even more relevant, as they offer lenders a digitised service versus existing paper-based processes to check affordability. They use real-time data that enables lenders to better assess the changes of financial conditions of applicants. TransFICC has developed a new fixed income connectivity layer for e-trading. Their single API allows banks to easily connect to trading venues, streamlining technology requirements and reducing operational costs."

Paul Lehair, Investment Manager, AlbionVC

THE FINTECH50 2020

Moore Kingston Smith is proud sponsor of The FinTech50, an annual list of the hottest fintech companies in Europe. This year's FinTech50 is actually a 'FinTech70', featuring 'The Fintech50 2020', a 'Hot Ten' of early-stage innovators, and the 'Top Ten' ranked fintechs in Europe. The ranking is now in its eighth year and was the first curated list worldwide to feature fintech companies and their innovation. This year's finalists, shortlisted by a selection committee of industry experts including our Head of Financial Services and Fintech, Tom Moore, can be found here.

METHODOLOGY

The data is from analysis conducted by Moore Kingston Smith on data extracted from Pitchbook on UK private companies raising £1 million to £20 million each of growth equity capital.