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Industry Commentary

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Money20/20: Four Themes Shaping FinTech's Dealmaking Environment

Companies providing solutions related to software-led payments, B2B payments, RegTech, and BankTech are attracting high levels of interest from investors and strategic acquirers.

Each year, the Money20/20 conference in Las Vegas attracts a broader, more diverse audience to the desert to learn about the latest trends in the financial technology (FinTech) industry. This reflects the fact that technology is continually becoming more pervasive and a more integral part of the financial ecosystem—from building omnichannel experiences that drive customer acquisition and retention to automating mundane back-office tasks and enhancing operational efficiency.

William Blair's FinTech investment banking team identified four areas of the broader industry that are seeing heightened levels of M&A and capital-raising activity. Based on our conversations at this year's Money20/20 with corporate development executives, business owners, and investors—as well as insights from the 16 FinTech transactions we have completed in the last 18 months—we analyze the forces that are driving dealmaking activity in each of these four areas.

Software-Led Payments

The integration of payment processing with vertical-specific software has resulted in a tremendous amount of transaction volume flowing through platforms that offer mission-critical, holistic capabilities for specific end-markets. This has led to aggressive interest from financial sponsors and strategic buyers and premium valuations for transactions involving integrated payments.

From a strategic perspective, much of the acquisition activity is being led by payments companies that view software platforms as a highly efficient business model to capture payment volume from end users. This represents a significant shift from five years ago, when payments companies were primarily interested in simply partnering with software providers. Today, payments companies realize that by bundling their services as part of software that companies rely on to handle a broad range of mission-critical aspects of operations—from accounting to workforce scheduling to client communications—they can improve customer loyalty and avoid competing simply on price.

While this integrated payments trend is occurring across many end-markets, buyers are particularly attracted to software providers that serve verticals whose business models rely heavily on subscriptions or other forms of consistent, recurring payments, such as child care, real estate, and fitness centers. William Blair advised Procare Software—a portfolio company of TA Associates that provides integrated child care management technology solutions to preschools, daycare centers, after-school programs, and camps—on its strategic investment from Warburg Pincus.

B2B Payments

In the business-to-consumer (B2C) world, the transition from paper to electronic payments has advanced to the point that a growing percentage of consumers no longer use cash or checks. But in the business-to-business (B2B) realm, a surprising amount of accounts payable and accounts receivable transactions are still conducted via paper invoices and checks delivered via mail. Less than 10% of global invoices are processed electronically, according to the 2017 E-Invoicing/E-Billing Report by Bruno Koch of Billentis. The manual labor involved in processing invoices results in higher operating costs, delays in generating cash flow, and higher error rates.

Because electronic B2B payment is still in its early stages, it is considered one of the last true “white spaces” in payments and remains highly fragmented. In the first half of 2018, there were 40 venture capital– and private equity–backed investments in B2B payments totaling $1.1 billion, matching 2017’s full-year total for deal value, according to PitchBook. Given the vast number of small, emerging players in B2B payments and the sheer size of the potential market, continued investment and consolidation are inevitable.

As this occurs, investors and buyers will prioritize companies that provide e-invoice and e-payment capabilities (automating accounts receivable and accounts payable) and the ability to integrate with a company’s existing ERP and accounting systems. These characteristics, along with the secure tokenization of payment data, were major value drivers for Paymetric in its acquisition by Vantiv (now

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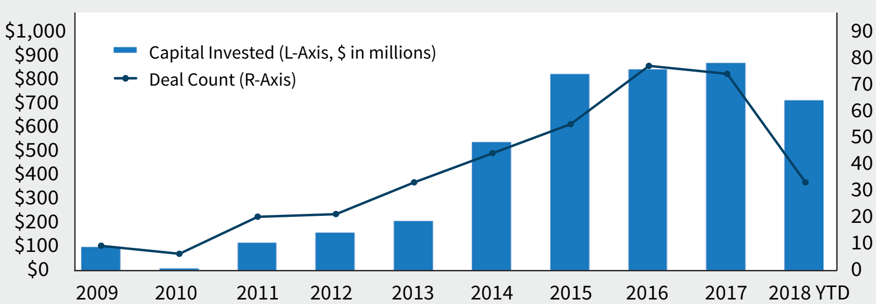
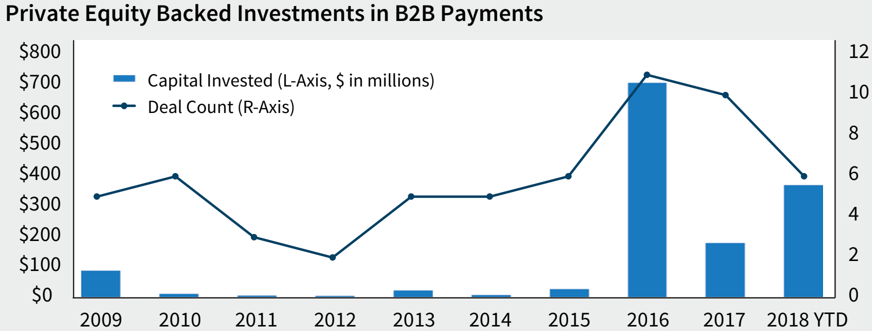
Private Investment in B2B Payments - 1H 2018

Considered by many to be the last true “white space” in payments, B2B payments attracted a combined $1.1 billion in venture and private equity investments in the first six months of 2018, matching 2017’s full-year total.

Venture Capital Backed Investments in B2B Payments



Private Equity Backed Investments in B2B Payments



Source: PitchBook Data, Inc., data through June 30, 2018

Worldpay). William Blair advised Paymetric, a portfolio company of Francisco Partners, on the transaction, which significantly expanded Vantiv's B2B presence.

RegTech

Regulation technology (RegTech) is one of the fastest-growing segments of the broader governance, risk, and compliance (GRC) technology industry. Drastic increases in the number, complexity, and severity of regulations facing banks and other financial institutions since the financial crisis have fueled surging demand for technology-enabled solutions that allow companies to efficiently comply with these requirements. Juniper Research estimated that global RegTech spending will increase at a compound annual growth rate of 48% from 2017 to 2022 and go from representing about 5% of banks' total regulatory spending to 34% over that span.

In addition to compliance with Anti–Money Laundering (AML), Know Your Customer (KYC), and other regulations, financial institutions are increasingly relying on technology to manage payment risk and fraud prevention, tax management, portfolio and credit risk, artificial intelligence and predictive analytics, and trade risk and reporting.

A more recent trend in the GRC market is integrated risk management which provides one technology solution for customers to manage various GRC processes, such as digital risk management, audit management, and corporate compliance and oversight, instead of using a collection of disparate, siloed solutions. This consolidated solution allows a holistic view of risk for an organization, enabling more efficient and strategic risk management. As more capital flows into the industry, financial sponsors are focused on making acquisitions to consolidate automated GRC capabilities into integrated platforms that provide one-stop shopping for customers.

William Blair advised Trintech, a portfolio company of Vista Equity Partners that automates the entire financial close process and enhances and expands compliance and regulatory reporting, on an investment from Summit Partners. William Blair also advised Avetta on its sale to Welsh, Carson, Anderson & Stowe and TCV. Avetta, a former portfolio company of Norwest Venture Partners, is a provider of health, safety, and quality cloud-based technology services to contractors. So far in the second half of 2018, there have been several significant acquisitions or capital raises involving RegTech companies. In July, A-LIGN, a cybersecurity and compliance solutions provider, raised $54.5 million in growth equity from FTV Capital. In August, ComplySci, a RegTech provider for financial and professional services companies, announced a strategic investment from Vista Equity Partners. And in September, PwC announced that it is acquiring KYC-Pro, an AML and sanctions screening tool.

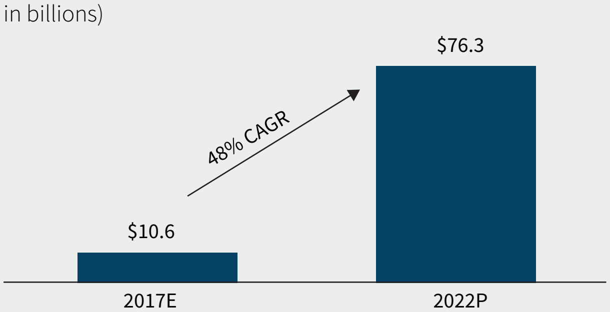
BankTech

Beyond complying with regulations and protecting against security threats, banks are facing a host of other challenges requiring them to use technology and embrace digital transformation. Shifting customer expectations and disruption from nonbank competitors is forcing banks to invest heavily in creating digital omnichannel experiences for their customers. Part of the effort to attract, retain, and grow customer bases involves using data analytics and machine learning to gain a better understanding of consumers' needs and deliver innovative products. In the back office, banks are using automation to reduce operating expenses and bolster margins, as well as modernizing IT infrastructures.

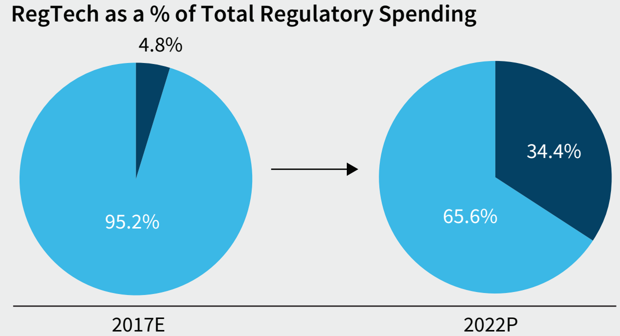
Trends in RegTech Spending

As banks increasingly rely on technology to manage the stringent compliance requirements implemented since the financial crisis, RegTech spending is projected to surge, consuming a rapidly growing portion of banks' budgets.

Global RegTech Spending
($ in billions)



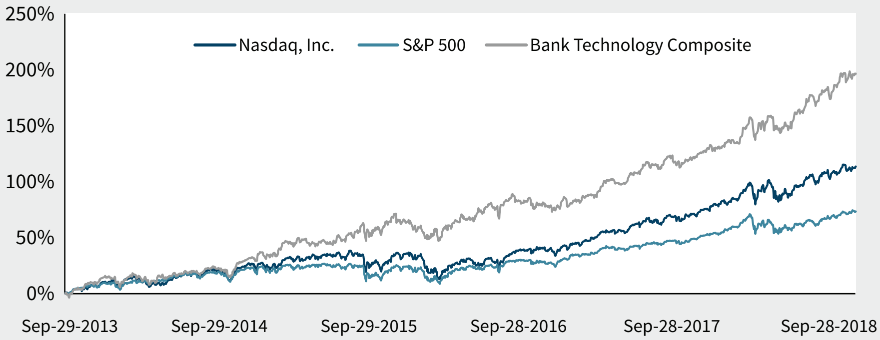
RegTech as a % of Total Regulatory Spending



Source: Juniper Research, "How RegTech Can Save Banks Billions" (2017)

Five-Year BankTech Composite Performance

The outperformance of BankTech companies reflects banks' growing need for solutions that help them navigate the industry's digital transformation and consumers' demand for omnichannel engagement.



Source: Capital IQ as of September 28, 2018; composite comprises ACI Universal Payments, Bottomline Technologies, Ellie Mae, FIS, Fiserv, Jack Henry & Associates, Q2, SS&C Technologies, and Temenos.

One area that has been attracting significant interest from investors in 2018 is digital lending technology that helps streamline the credit decisioning, loan generation, and servicing process for banks and their customers. In May, AKKR acquired Sageworks, a provider of lending, credit, and portfolio risk technology solutions to financial institutions, and merged it with Banker's Toolbox, its risk and compliance portfolio company. In June, Thoma Bravo acquired and merged MeridianLink, a multichannel account opening and loan origination platform, and CRIF Lending Solutions, creating a comprehensive lending financial services software platform. More recently, in August, Q2 Holdings announced the acquisition of Cloud Lending, a SaaS provider of integrated end-to-end lending and leasing platform.

The rapid growth of the banking technology (BankTech) industry has led to a high degree of activity from strategic buyers and financial sponsors. William Blair advised Dovetail Group, a provider of payments and liquidity management solutions for banks, on its acquisition by Fiserv. William Blair also advised Velocity Solutions on its acquisition by H.I.G. Capital. As smaller institutions struggle to compete in the digital arms race that defines modern banking, companies that provide technology tailored to the needs of regional and community banks and credit unions, such as Velocity Solutions, play a particularly important role.

To learn more about the trends that are shaping the dealmaking and capital-raising environment in FinTech or to discuss some of the takeaways from this year's Money20/20, please do not hesitate to contact us.