The Current State Of Fintech

3 DAYS AGO JUN 13, 9:25 AM EDT, 2022

Bill Stephenson

9:28:19AM

Alright, that was great. We have Nash Patel here. He's going to give us a state Fintech. So Nash will be here for about 20 minutes on his discussion. We will have some time for Q&A maybe at the end.

Okay, so if there's any Q&A at the end just raise your hand and then after that we'll head right into the company presentations. Thank you.

Multiple speakers

9:28:51AM

Alright. Give me just a second year to get my bearings. It's the least exciting page of the presentation. [inaudible]. Yes, I hope.

Nash Patel

9:29:03AM

Ok well, thanks everyone for the opportunity to spend a few minutes here with you. I think Bill said I have about 20 minutes, I have about 30 slides, so I'm going to move through these as quickly as humanly possible and I'll try to cover a little bit about what I see going on in the world of Fintech. The presentation might be a little bit different from ones you have seen in the past. It's really informed by the conversations that I'm having with my clients, which can be public companies, private companies of all shapes and sizes. Just as a little bit of background, I've been a banker advising companies on M&A capital markets, capital raising since 2008. I focus on financial services, technology, and primarily Fintech for that entire time. The last six years of that has been at PJT partners, which is about the age of our firm. So if you haven't heard about us, I'm not surprised, but hopefully, you will hear about us more and more. A couple of things that I've been able to do in and around this space: on the larger side: I advised the merit trade on its sale to Schwab. I advised [inaudible] Mason on its sale to [inaudible] resources. And the more kind of tech port innovative side, I advised Vanguard on its first-ever corporate transaction on the acquisition of Just Invest. I sold the business called Optimal Asset Management to [inaudible], part of B&Y. I advised [inaudible] investment and sold a business to Orion. And finally, I advised [inaudible] Capital on its capital raise as well as the M&A back in 2020. So I have found my way around the space and hopefully, that's going to help inform some of the comments here that are relevant to you.

So let's just set the stage, what's going on in the broader public markets? Many of you have probably seen this, it's one of my favorite websites. It's the Fear and Greed Index from CNN. We are in a period of near extreme fear. In fact, I've had dipped into it quite a bit in the last couple weeks, rebounded a little bit nicely. As of today, we're actually down back around, I think, 25 or 26, so hovering in a very fearful place. The two big ones in terms of those index factors: market momentum obviously is one very easy to see and observe for most of you, but people take note of the general trajectory of stock prices in the public markets and part of that is also the safe haven demand. So it's really built on not the overall market dropping but a rotation of where people are willing to put risk in capital to work.

Macro dominates the headlines and really [inaudible] around investor perspectives right now. I mean, people are trying to get their heads around how each of these factors, and a number of other ones are going to play a role in in terms of helping them understand and think about outlooks. So where is rising interest rate environment, where is it going to go? How quickly is it going to go up? Where will it settle, for how long? A lot of big unknowns are around. That drives a lot of behavior, as many of you already know, geopolitical events and conflicts- I think that one speaks for itself, global supply chain, which are all over the headlines, the pandemic-related disruption. There is also the pullback of a lot of pandemic-related behavior and activity which one gets the Fintech section- you'll see how that's played a disproportionally large role in the way valuation and investor activity has behaved in that space. And then finally, inflation, which I think is hitting levels that we haven't seen in a generation or so, and the role that's going to play in terms of how investors think about putting capital to work, again, [inaudible].

Tech is bearing the brunt, no surprise here. But the NASDAQ has pulled back a bit more than the broader market indices have. NASDAQ is not unfamiliar with drawdowns, kind of post dot com you've seen a couple big pulldowns in the NASDAQ. This so far is not one of the bigger ones, so there might be some room left to go.

I'm not going to predict that, and the reason is, again, as I said, real rotation here into value, right? The shift away as of late has risen, people have started to look for less speculative companies, right, less ability to kind of focus on growth and technology innovation and looking for safer havens, so as we talked about before.

Newly public companies also getting a fairly cooling perception I call it, the cool reception here, it's cooling rapidly. They saw the performance and broad portfolio of IPOs, they were performing in lockstep with a market for a period of time. Towards the end of 2021, they decoupled and it's now you see them dropping, underperforming the broader market by almost 50% right, relative to the S and P, and that's going to play an important role, not only in this psychology of a lot of those companies that are out there and what they're going to think about and do, but also the plans that certain people had that they had not yet executed on with respect to IPOS and other exits, [inaudible] being mainly one of them, and you've seen a big drop off in that level of activity and outright cancellations. Suspect transactions again, plenty of you probably already know, but we have seen more and more [inaudible] transactions that's starting to terminate or expected to be terminated. IPOs have been withdrawn. There are a number of big ones that haven't officially designated where they're going to go but state that they're looking very closely at this market, looking closely at the comparable levels, there just happens to be a tremendous a number of new comparables for certain industries, Fintech being one of them, and all of those are trading not so great.

But if you go from the public markets to the private markets, they pulled back as well and you see the private markets here, this is an index that we put together, Venture Capital Industry Index actually broadly track the performance of valuations of the venture back in our committee. So on a private company it is not available for investments from the public markets. And you see: one- a dramatic expansion in the overall size and the level, right, kind of post the great depression or great recession era where more and more private capital was formed and accumulated in bigger and bigger kind of pools of venture capital available that did drive in part valuations, but you can see very recently like a dramatic pullback in that and that's tied directly to expectations around where all those valuations have gone. So the private market is starting to internalize that which the public markets had started to demonstrate a little bit ahead of time. Again, not so surprising, there's always this kind of linear area to have public sees first then certain parts of private, than it feeds into the B2B and even the gentleman that worked there before will probably tell you that the crypto world, which many you assumed was going to be immune to certain pressures like this, it started to penetrate the conversations that investors are having on that front as well.

So the current still being [inaudible], but slowing down very quickly. So I think what you had was the momentum from a lot of capital raises that were happening and planned towards the end of last year in motion, and a number of them have closed, will close, but the number of new conversations that are starting are going to top tick and reward higher valuations is going to slow down. And this bump you saw here was largely, I think, a result of capital velocity, the risk profile that the macro backdrop was support above until now and deal values go up, but the amount of a company that you could reasonably buy in a race is about the same, naturally that means valuations had to go up as well. That's all kind of pulling back at the moment.

That being said, the private markets are sitting on an absolutely amazing amount of dry powder right now- $3.2 trillion- and that is built on the back of record fundraising across all different stages of private capital, right early, mid, and late stage private capital. And, interestingly enough, about half of it was raised just in the last two years. And so what I think will happen, and while there may be some hesitation you see in the markets right now, people are just taking stock where they are, resetting price expectations, risk parameters and the like.

The natural pressure to deploy will start to creep back in and what role that's going to play will be an interesting one. I predict it will affect quality and the best companies will receive a tremendous amount of opportunity and how they choose to take that capital in and structure it and price it, and whether they continue to do what they might have been doing or whether they find other ways to purpose that capital will be interesting and the rest will find more opportunistic players who they couldn't find their way into the best companies that will find incredibly good opportunities for the next year.

So with that backdrop, let's talk a little bit about Fintech and what all that means in the Fintech world. Fintech has certainly not been immune to the changing market, so all the energy and enthusiasm, and opportunity that people saw in the industry was not able to kind of punch through the macro factors that have kind of touched the overall markets. And in fact, if you look at the numbers here and I'm sorry [inaudible] to what you saw on some of the other pages, but Fintech is probably an over index or overperformed on the downside in certain categories relative to the broader market. So you see some of the bigger industries [inaudible] later crypto, and sure tech on the left-hand side of the page, down 70% or so relative to the NASDAQ, which I saw, which lasted later about 17% over the same time period down. There are a few places that have been less impacted, so B2B, payments, what we call other, but is really a bunch of technology and other software companies in the Fintech space, those have been less immune. I think what we'll ultimately touch on and what you probably may expect is there is a certain discretionary component to retail and discretionary component to the businesses on the left side of this page and that behavior, because of the macro backdrop, is what's pulling back on those businesses and changing perspectives around the growth of those businesses, less though for the companies that truly are delivering software or very recurring, stable types of revenue and eventually the profitability. Returns by listing type- again very interesting- the two red bars, recent IPOs, recent specs, have dramatically performed in the market relative to the public companies are just essentially the companies that were already public prior to this period of time. And again, if you're trying kind of see the activity levels that have happened across Fintech, the IP0s and specs have been those businesses predominantly that were tied more to discretionary type activity, so not anything too surprising there.

Now, what is interesting is as these evaluations have retreated, even in Fintech, we talked about the broader rotation before that chart with the Russell component tree shifting from growth to value. If you look in just Fintech alone, you have two things that have happened, and I'll help you interpret this chart. So the grey dots were where growth and multiples were before, right? Growth on the- what is that, the X-axis and multiple is on the Y-axis. So you see the green dots are where things are now. So growth has come in, right? Growth has come in, in some cases a good like 10-20%, so expectations of growth are lower. Now that dotted line you see has an actual slope when you look at the grey dotted lines. That meant that there was actually some relationship between the perceived expected growth rate of a company and its valuation. That line is now essentially flat, which means the growth rate of a company as a standalone metric is much less, if not determined at all as to the multiple that the market is willing to put on a business. Now, this is just Fintech companies, right? So I've narrowed it down here from the broader markets to a group of 60 Fintech companies, which I think is very interesting. You've heard a lot about revenue multiples and the role they played. Right now the market is not really looking at them that closely.

And so Fintechs have declined more than others and I talk about this a little bit, but I think just use this as an example or a page to talk about why it has declined more than other SaaS companies or technology companies where you enterprise Saas the big find. So that's the grey line that Fintech started with, which is the green line. They're both around 15 times four multiples about a year ago today. You've seen Fintech cut down to about half now of where the enterprise tech companies are. And the question is why? The question is well one--a lot of these Fintech companies at the time kind of played into the notion that they could advertise SaaS or SaaS like revenues- right, which is a very nice way to say, "Hey, we think we have really strong recurring revenues. They may not be subscription-based, but we have a pretty good level of certainty and clarity as to the fact that they're going to keep coming and they're going to grow along a nice curve." And if you look at the growth rate of most enterprise software companies, it was very like, smooth and nice and people got excited about them. What turns out is that a lot of the companies were actually built on transactional-based models, right? So those transactional-based models, when the transactions themselves were behaving in a nice upward sloping line, increasing in terms of the number of frequency, they did actually start to look like software companies. The problem is, if the transactions were tied underlying to retail discretionary activity, right, whether it was in the [inaudible] space or the crypto space or otherwise, they actually don't perform like software companies, right, because the turn component of the software company would not see the type of drop off that you see when retail is all of a sudden risk-off or choosing to spend their cash differently and much less discretionary in nature. So you see, this big pullback which is going to force a lot of the companies in the space to think really hard about how to position themselves with investors and whether they can truly rely on a set of growth plans if they don't recognize the fact that there might be other factors besides just an up into the right trajectory of things driving the way their business performs.

So Fintech fundraising has to date actually been really robust and strong. This is a lagging chart. This goes through the second quarter, but only through really the month of April. What I will tell you is if, when the reports come up for May and when they come up for June, what you will hear and find is that it has kind of slowed down dramatically. It is not closed. This is not meant to be a doom and gloom-type conversation or speech. What has happened though, is it slowed and investors are focusing heavily right now on their portfolio companies, on the exposure that they have, making sure they know exactly where those businesses are, and then they are opportunistically looking for places to put money to work. And so part of that is just waiting for the broader market environment and the ability to take a position on how to think about outlook has reset itself and letting that reset will allow them to start taking these actions. And again, if you recall, the comment I made earlier, I'm strongly of the belief that you cannot sit on dry powder when your job is to actually deploy capital. So at some point, they will naturally feel just a pressure--particularly if others start to do it-- to go and find places to put money to work. So I think you will continue to see good Fintech funding. Will it look like the couple of months prior? Probably not, but there is still capital to put to work out there.

Exits have cooled. And again, if you think about what actually drove exits, if you look at the bottom two charts, like that big grey bar, that's public listings, right? So that is the value of public listings that enter the market. That prompted a lot of activity on the private side as well, because there was some belief at the time that there was going to be a generous appetite from the public markets to continue to absorb companies as they got to the stage and scale that they would need to. That has fallen off dramatically, as we talked about a little bit earlier on the broader market. The same is definitely happening on the Fintech side of things so you see a lot of activity in Fintech shift almost entirely toward M&A as the preferred exit source. And what's interesting about that is, while the market may have certain patterns and behaviors and you look at how public investors and private investors are behaving strategics, particularly well-capitalized strategics, are looking at this as the golden opportunity to make the moves in the space that they have been waiting years to make in space right? Like they needed to accumulate technology capabilities, products, sometimes even scale, better reach into different demographics. This is now the time where they're all rolling out their shopping list and starting to think really hard about: can I actually put this capital to work? Is this the right point of time? And so I think what you will see in the next year or two is strategic exits becoming a predominant source of exit opportunity for a lot of companies, and you have a lot of founders and a lot of CEOs and a lot of management teams thinking really hard about this relative to other options.

Public companies, again as leading indicators, have already started pulling levers in light of this environment. So again pulling a little bit broad around the plenty of financial services and other recent companies in the space up here- whether it's hiring increases, whether it's outright layoffs, whether it's publicly saying, "Hey, we're going to make some serious operational changes." You are starting to see companies in the public domain saying like: we recognize that the world is different, we recognize that we have to run the business differently now if we want attention from investors, and so they are doing so. You are seeing a lot of that in the private markets as well. So private market participants, even in some very high-flying areas, like payments from crypto, have also started to make very proactive moves to shore up their balance sheet and their liquidity, be more efficient with their operations, and really drive for like profitable revenue growth right, which means taking a hard look at the business of doing and finding places to play. You will unfortunately see examples like the company on the left there which they essentially fully shut down this fast. Hopefully, we don't see too many more of those, but it is just beginning. People are starting to take a really hard inward look which is the right thing that is supposed to happen in this market environment. Most people who have gone through a cycle or two recall that this is what happens. People start to looking inwards, the companies who do it successfully will be on the front-end of that curve and have the best chance for long-term success. The companies that don't will ultimately suffer.

So here's where this ties into what my clients come and ask me about. They say, "Well, what am I supposed to say? What am I supposed do now because this all sounds really bleak?" And I say, "Maybe it does sound bleak but actually, the good news is, one--history actually is quite informative as to how you can navigate this environment. Two--it's actually just hard work but that doesn't mean it's impossible." So first and foremost is just taking stock and inventory of work capitals flowing or what people care about right now and what lessons they've learned from the last two years. And this was inspired by something that was forwarded to me by an investor that I respect a lot and it has made its way in some circles, but it's a little tongue-in-cheek about what investors care about today versus what they cared about in 2020 and 2021. So a couple that I'll highlight for you, so the top row, whereas the narrative might have been a really great thing for investors to hear, now they want to see some math. Second, revenue growth--revenue growth was great, but now tell me about your free cash flow and how you're multiplying that over time. Management vision--like just bold aspirational management vision tended to be enough for people to write some checks. Now they actually want to know that management has some scars that they've learned from. The digital transformation right, like having bold visions as to the nature of the transformation that you're going to affect. Now they just hope that the company is not going to blow up.

And the one that I actually think is really important, they sound great. The point in time where people said, "Look, that actually sounds like a really interesting idea. They seem like really good people." Because of some of the examples you've seen in the space, I think, honesty, integrity, the ability for someone to actually come across as trustworthy as an allocator of capital, right? If any investor gives more money, they essentially made them an allocator of capital, they're trusting them to allocate that capital appropriately. So honesty and integrity are going to also play up pretty big.

So I talked about the hard work, I try to boil it down to four simple questions that I ask CEO's who call me and say, "What should I do?" And I said, "Well, one--look, let's just take stock of where you are. Have you established part of the market? Are you in the market? Are you still building? And if you're in the market, are you strongly of the view that you've actually created a product that is resonating and working? Second, unit economics--do you have sustainable growth? Are you spending $5 to make five cents? Are you putting out a dollar and making two? Like let's be really honest about where our growth is coming from, whether we actually have any good data information, reliable way to know that you're putting money to work, because that's going to matter in the context of the next box, which is kind of liquidity and cash form that you have, right? What position are you in with respect to needing money, having money, access to money? And then finally access to capital, right? Where are you with respect to your current investors? What is your [inaudible] in terms of the amount of support they can provide for you? You want to have conversations with other investors who may be looking to invest in your business, informed for it-- All of which helps you establish kind of where you are on, I'll call it a continuum of options, right? Like if you have very little runway and you don't have product-market fit and your expectation is that you're going to have to spend a lot of money to establish public market fit, you might be in a pretty tough place right, and you may want to think really hard about just cutting burn and seriously pulling back on everything and maybe even finding a quick strategic exit because it's unlikely in this market that you going to be able to grind it out unless you have true conviction that you can power through it. On the other hand, there are companies out there that have 24, 36, 5 years of burn, plenty of burn, great product-market fit, is now the time for them to pull back or is now the time for them to take advantage, right? So it actually depends on where you are on that continuum that will inform like the right way to play this environment.

And there's plenty of advice out there, plenty of advice from people much more than me about what to do. I do want to reiterate the fact that I believe that there is not a one size fits all answer for a company right? It depends on your circumstance or situation, and if you take an honest look and really assess where you are, then you can use all the advice and information that's out there to your benefit, right? For some people, it is not pulling back. For some people, it's actually hitting the gas and using this as a way to consolidate, roll up, acquire new customers organically. Whatever the case may be, they have the ability to leverage this environment in their competitive position, both from the capital and product standpoint, to win.

And remember, as I kind of close out here, no matter how dark anything I said during this presentation was, I actually think you should never let a good cycle go to waste. What comes out of moments like this is the truly great innovation, not only on the innovation side but on like the actual operations, go-to-market product marketing, all those components that make a great business. This is where necessity breeds this opportunity, right? And so you see, we've gone through this before some really big, great companies have emerged. Because most of this conversation has been around things going the other direction. I left the ones that failed because the point is any company right now could be one of these companies, right? It's just about the decisions you make and the steps you take. Some of these companies started out of a crisis, and some of them actually started before and survived the crisis, particularly the ones from the dot com era.

So as I close, I did say to Bill that I was not going to like come and show a bunch of Fintech trends in areas that I thought were going to be the big winners, but I couldn't help myself. So in terms of this ecosystem, because when I talk about Fintech I gave a pretty broad point of view, but in this ecosystem, there are a couple of things that I'm excited about that I think will actually kind of pull us through, and I'm almost smart enough to know that I don't know everything and there is going to be some people tinkering and thinking about really great ideas that we don't even know about yet. But some of the ones I like, the role of AIMC, right? Like the lending industry has seen a number of companies come out and try to try to use this. But I think this industry, the investment management industry, has so much more potential in terms of putting that kind of capability to work. At the tokenization, the gentlemen that were sitting here before me sit in an industry that is looking for solutions for the technology to develop. I think as it makes its way into the world of asset management, investment management, there is a real opportunity for tokenization of assets to help produce friction there, and help increase access to capital. Private markets alternatives, rise in retail, the need for diversification, the fact that you can't get as much [inaudible] just from the list of public equity markets, create a lot of opportunity for alternatives and private markets, and again, I believe people are still allocated to it as a broader point.

Distributing lender technology, again, it seems like it may be kind of grand in its vision in terms of the role it's going to play. It might simplify things. If there's any sort of friction or transaction cost in this world and there is some technology that has a chance to remove friction transaction costs, it will eventually happen. It's like betting against the Internet. It may not happen today, but it's going to happen. Meta verse virtual assets, again, a whole new asset cost emerging. We thought about the world and equity six and income real estate commodities, and all of a sudden we have to start to think about where hundreds of billion of dollars, maybe trillions of dollars of value are going to accumulate in completely different types of asset classes in the virtual world. Next-gen connectivity, 5G, 6G, like advanced networks--all of that has distributed more and more computing power connectivity access, sensors, other things are going to increase the amount of data that's available in this world, all of which people can harness and maybe they'll harness that using quantum computing, which a lot of people are predicting 2022 is going to be the year of quantum computing, we will see. But there are real advancements that are being made in that space and the computational power of these projects that are happening in the quantum computing world is absolutely astronomical. And so I'm optimistic that when you put all these things together with a lot of ambition and great minds, we're actually going to see some really exciting things come out of the little downturns here. So now, with that, I don't know if we have time for questions. I'd try to do it as quickly as I could, but happy to answer any questions. Yes, please.

Unknown Speaker

9:56:54AM

[inaudible]

Nash Patel

9:56:55AM

Yeah.

Unknown Speaker

9:57:03AM

[inaudible]

Nash Patel

9:57:04AM

Absolutely. So Let me first give a little bit on PJT partners and then that will help qualify the answer. So we're an advisory-only banking firm, right? So we provide any advice, capital raising advice, private market, capital raising advice, and capital structured advice, but not execution. Similarly, we also have a restructuring practice and our Park Hill group, which is a fundraising practice. I say that because we don't have the lines of business that I think are most likely to feel pressure from some of the innovation that's going on like in big capital market sales and trading businesses, which the spreads on those have come down. The amount of technology that is replicating the work that was done by individuals before has gone up, and in general, people always seeking new ways to distribute and allocate capital and the traditional kind of sales force institutional relationship model, whether that will be reinvented or that'll be disrupted is anyone's best guess, but I think that's where the industry is seeing the most pressure. Now for us though, we are big believers in finding ways to use technology right, to make our job more efficient. We do to a certain extent believe that a big part of our role is relationship building. So the same way you see in the wealth management industry wealth managers are starting to use technology to handle more and more components of their business, but the simple relationship and advice-giving component is still the job of an individual, we think it's probably going to play a role in the way we do things. So making sure we have access to the best data, the best information, the best systems for actually just running our business using technology to keep track of all the conversations and interactions and clients that we have to make sure that we're compliant from a conflicts perspective. And like, those are all things that we're spending time and effort and energy on to make our businesses as efficient as possible. But like certain other industries, there is still a human component to advice that we have not yet found a technology to truly kind of advance, so we leverage technology as well as we can.