



Google Cloud

Fintech Focus

#UKFintechFocus

July 2020

kpmg.com/uk/fintechfocus

About KPMG

KPMG LLP, a UK limited liability partnership, operates from 21 offices across the UK with approximately 17,600 partners and staff. The UK firm recorded a revenue of £2.40 billion in the year ended 30 September 2019. KPMG is a global network of professional firms providing Audit, Tax, Legal and Advisory services. We operate in 154 countries and have over 200,000 professionals working in member firms around the world. KPMG fintech professionals include partners and staff in over 50 fintech hubs around the world, working closely with financial institutions and fintech companies to help them understand the signals of change; identify the growth opportunities; and to develop and execute on their strategic plans.

The independent member firms of the KPMG network are affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

About Google Cloud

Google Cloud is widely recognized as a global leader in delivering a secure, open, intelligent and transformative enterprise cloud platform. Our technology is built on Google’s private network and is the product of nearly 20 years of innovation in security, network architecture, collaboration, artificial intelligence and open source software. We offer a simply engineered set of tools and unparalleled technology across Google Cloud Platform and G Suite that help bring people, insights and ideas together. Customers across more than 150 countries trust Google Cloud to modernise their computing environment for today’s digital world.

About the Author

Michael Pearson is the founder of Clarus Investments and is an experienced director, investor and consultant who is recognised globally as an expert on strategy and innovation in financial services. Michael has more than 30 years of experience in financial services and strategy consulting. He advises start-ups, investors and established companies in developed and developing markets on strategy, innovation and all aspects of corporate development. Michael has an MA from Cambridge University and an MBA from Harvard Business School. Prior to establishing Clarus Investments in 2006, he worked for Lloyds TSB in corporate strategy, development and venturing roles.

Purpose of this Report

KPMG’s Pulse of Fintech research is tracking the dynamic and growing UK fintech sector. With a lack of in-depth analytics on the sector for founders, investors and services providers, our multi-year research programme is shedding light on the performance of fintech start-ups and the opportunities for the UK to realise significant benefits from the combination of our technology entrepreneurship and world leading financial services.

This report builds on our initial findings from 2019 and we will continue to evolve the research to provide both direction and a sounding board on sector progress. Expect us, with our ecosystem partners such as Google Cloud and Innovate Finance, to continue to develop these insights as the sector progresses.

Contents

Google Foreword	4
Executive Summary	5
Calls to Action	6
Key Findings	7
Research Overview	8
Fintech and the Impact of COVID-19	10
Performance Trends	14
Financing Trends	20
Valuation Trends	26
A Sector and Vertical Comparison	32
Methodology and Research Notes	36
Points of Contact	40

Like most sectors of the economy, UK fintech will face some key challenges as a direct result of COVID-19, including a significant funding gap. We need to collaborate as an ecosystem to address these challenges and protect the increased access, transparency, and inclusion that fintech has brought to our financial services sector over the past decade.

The UK is known around the world for its leadership in financial innovation, and fintech has a vital role to play in society as our economy recovers and the digitisation of our lives accelerates. This report highlights how important it is for investors and entrepreneurs to work together to ensure the continued democratisation and transformation of financial services.

Janine Hirt
Chief Operating Officer, Innovate Finance

Google Foreword

Focus on Fintechs: The case for operational efficiency and cost reduction

Over the past few months, our world has changed. However, during these challenging times the unique DNA of fintechs can thrive and illuminate an otherwise unnavigable path to financial recovery. Indeed, fintechs are well suited to analyse and optimise existing workflows which may be inefficient, brittle, and static.

For most fintechs, it's not simply about spending less; it's about project prioritisation and product feature optimisation, often with limited and finite funding, in order to maintain business continuity and ensure longevity. But what does this mean in more practical and actionable terms? There are three main issues facing fintechs:

1. Fluctuating business conditions -

Fintechs, like other financial services companies, must keep pace with dramatically changing requirements to survive and thrive. IT teams need solutions which enable rapid and sustainable innovation, all to decrease time to market and time to value, and provide the agility and scalability needed to address frequently shifting requirements.

2. New investment needs -

Fintechs must adapt their business models to rationalise existing runways and reconcile product roadmaps with profitability. IT must now prioritise projects for investment, optimise existing projects and product features to reduce the runway to profitability, and potentially even pivot existing projects and products to reduce burn rate, all with a view to ensuring the survival of the business.

3. Limited visibility and control -

Given a rapidly changing landscape, few startups have a complete picture of their IT spend to make educated decisions about where and how to reduce costs, or whether to reinvest in other strategic areas. Fintech leadership requires granular visibility and intelligent services that remove risks associated with cost and resource optimisation without compromising data security nor the robust governance required in the financial services sector.

It is often said that, 'Cloud isn't something you buy, cloud is something you do'. Fintech leaders need facts, knowledge, and best practices so they can swiftly address investment prioritisation aligned with cost optimisation as a function of process evolution. As fintechs accelerate their digital transformation, they need a platform to manage data at scale, ingest and analyse data in real time, develop and modernise applications, and leverage new artificial intelligence AI capabilities in meaningful ways.

Google Cloud supports financial institutions as well as the evolving UK fintech market. KPMG's research offers keen insights into the fintech market, where there remains a mix of excitement and uncertainty—but tremendous opportunities across this thriving sector. Additionally, Google Cloud is committed to maintaining the health of our systems that support the financial services industry, and can help empower our customers' business continuity planning and resilience.

The vast majority of financial institutions and fintech start-ups already see the benefits of cloud-based infrastructures as they offer more flexible computational capacity. In 2020 and beyond, the smart path to surviving and thriving in these uncertain times leads to a focus on operational efficiency and cost reduction.



Google Cloud

Matthew Yeager

Head of Startups, Architect
Google Cloud - Digital Natives UKI

Executive Summary

This report follows on from the UK Fintech Focus we published a year ago which aimed to provide a better understanding of some of the dynamics of performance, financing and valuation of UK fintech start-ups.

We have expanded the research this year to include 100 companies with a broad representation across the main fintech verticals, covering both financial services and technology/processing businesses.

In the past 12 months, the sector has continued to thrive. KPMG's Pulse of Fintech research found that venture capital investment, private equity investment and M&A in the sector reached £38.4 billion in 2019, up from £20.1 billion in 2018. Continuing the momentum, several large funding rounds were announced by our sample of companies in the first quarter of 2020. This progress across the sector has now been halted by the emergence of the COVID-19 pandemic.

We noted in last year's report that profitability has been hard to achieve for fintech start-ups and the trend has continued over the past 12 months. For some, profitability has not been a high priority as the focus has been on building scale. We estimate that annual losses for fintech start-ups in the UK which were started since 2010 are currently in the region of £1.5 billion. Investors have been willing to support these losses, even at companies which have been operating for several years. We think that the crisis will put increasing pressure on businesses to show that they have a viable business model and a clear path to profitability once markets return to something close to normality. Some of the companies in our sample have already executed strategy pivots and we expect that several more will need to do so in the next 12 months.

These ongoing losses, and the need for regular fund raising meant that going into the crisis, almost half of companies in the sector had less than 18 months of

funding on hand to cover future projected needs. We have estimated that the sector would need to raise approximately £825 million to get to a point where all companies had at least 18 months of funding.

This is achievable, with investors likely to support the viable businesses in their portfolio. However, it may accelerate the decline of some marginal businesses and add to the failure rate which so far has been relatively low in fintech.

We expect that valuations will fall in the next 12 months. At the very least, investors will seek greater downside protection for any new funding. However, investor returns on paper have been quite attractive to date, particularly for early stage investors. We also need to bear in mind that the sector overall (for companies founded since 2010) could be valued at around £49 billion. A modest decline in valuation will not be catastrophic and investors are not going to abandon their valuable holdings without very careful consideration.

Only two companies in our sample achieved an exit for investors in the past 12 months, and these were trade sales with unannounced valuations. That brought the total number of exits in the sample to four, including one IPO, which is still a relatively low number. We anticipate that the opportunities for a profitable exit could be even more limited until it is much clearer what the operating environment is going to look like post-crisis.

There will undoubtedly be many short and medium-term challenges for the sector due to COVID-19 but overall, we are optimistic that the long-term trend toward digitisation will accelerate. This will provide a boost to the companies which survive the crisis.

Finally, I would like to thank the highly-regarded industry leaders from across the fintech community who have invested their time to review the data provided through this report, to share their views on the results and discuss key topics that have an impact on fintech businesses across the UK.



Anton Ruddenklau

Partner & Head of Digital and Innovation, Financial Services, KPMG in the UK
Global Co-Leader for Fintech, KPMG International

Calls to Action

This year's findings, in the context of a socially distanced, and unprecedentedly disrupted, corporate landscape, bear some resemblance to what we learned in our 2019 Fintech Focus report, although in a much starker form. The most prominent themes in our analysis are the same themes that will heavily feed the forthcoming UK Fintech Sector Review being led by Ron Khalifa.

Our calls to action, therefore, build on our recommendations from last year but incorporate a new wave of challenges and opportunities facing the sector:

1. Patient scaling capital must be found

For fintech firms that are truly transformative with their business models, the path to achieving profitability at scale is likely to be 10 years plus. Likewise, for these firms to remain competitive, they will need to be fewer in number and more systemically important. Now more than ever, providers of patient capital – institutional investors – need investment data to support their participation.

2. Fintech market data requires significant maturing

The quality, reliability, frequency and scope of publicly available data needs significant enhancement in order to create a thriving, and self-aware, fintech ecosystem. Current data points, including the following research, contribute towards a patchwork of market intelligence, but they are not significant enough to move the sector forwards alone or, indeed, make it more investible.

3. Evaluating demand

Whilst market data is required for supply side evaluation of the fintech, little formal research is available on demand side either from legacy financial institutions or from adjacent sectors like e-commerce, healthcare, real estate or smart cities, for example.

Whilst it's appreciated that competitively sensitive research shouldn't be spoon fed to the private markets, it would be prudent to see at least legacy institutional trade bodies publishing content on levels of digitisation for their members. Likewise, the government's own industrial or digital strategies have a part to play here. Establishing common use cases for industry innovation and change will only benefit the entire ecosystem and, in particular, the end users of financial services.

4. Founder support

We sense that COVID-19 is sharpening the minds of the entire fintech sector – founders, investors, service providers and regulators – on what makes a prosperous and sustainable ecosystem.

Part of this maturing of sentiment – and consolidation of the existing waves of fintech businesses - will focus back on the basics. New or existing founders will need further skills, support and advice on:

- Investment case development that frames the right balance of ambition and feasibility
- Understanding what structural profitability is and how the unit economics of their business stack up
- Shortening the path to profitability
- Partnering for fast growth – effective partnering is a continued industry issue and involves much more than effective onboarding

Key Findings

This study builds on last year's research report and is based on a sample of 100 fintech start-ups in the UK across a range of verticals. The analysis considers the performance, financing and valuation of these companies based on statutory filings with Companies House in the UK and where possible extrapolates this to the whole universe of fintech start-ups which have been established since 2010.

- **Most fintech startups are still struggling to achieve profitability**

Although the failure rate of companies in our sample is relatively low with just 4 out of 100 companies going into administration, only 6% are at least breaking even and 84% of the continuing businesses reported increasing losses in their last financial year. Even companies more than 5 years old are struggling to reach profitability with 79% of this group increasing losses in their last financial year. Extrapolating from our sample to the universe of all fintech start-ups since 2010, we estimate the annual losses for the sector in 2019 were in the region of £1.5 billion.

- **Equity financing has continued to be available for loss making companies**

The more positive news is that equity financing continues to be available even for loss making companies that have been operating several years although, as companies get older, increases in valuation start to get smaller and investor returns on paper decline. The headline figures on investment are, however, somewhat distorted by the large equity financing rounds of a few companies, with 5% of the sample representing 70% of total equity financing in the past 12 months.

- **Investor returns on paper are still high but were probably falling even before the crisis**

The median internal rate of return on paper for first round investors as of the latest round of funding for each company is 71%. These returns typically decline as a company goes through multiple rounds of funding and if we adjust for this factor we find that the internal rate of return at companies raising funds in the past 12 months is 18% below what we would have expected. This suggests that valuations have been falling slightly.

- **Some notable differences between Financial Services and Technology/Processing businesses**

The primary difference between these two types of fintech is that the companies providing financial services tend to be the ones raising the larger amounts of funding (e.g. Revolut and Monzo). Some of these companies are also generating relatively high revenues given their stage of development but at the same time incurring relatively high annual losses. We observe little difference in terms of investor returns to date between the sectors. The Paytech vertical, which includes both types of fintech, does stand out from the other verticals in terms of investor returns which may be related to the successful exits taking place elsewhere in this business line.

- **The impact of COVID-19 on short term performance should be manageable**

As most of the start-ups in our sample have relatively low revenues and are loss making anyway, a short-term decline in revenues, if compensated for with some modest cost savings, should have limited impact on profitability. However, the crisis will push out the time at which businesses might be able to get to break even and hence there will be pressure to refine business models and adjust strategies to reduce the need for further financing.

- **Many companies need financing to fill funding gaps**

When heading into the pandemic, we estimate that just over 50% of companies in the sector had more than 18 months of funding runway which will help them get through without having to raise funds earlier than planned. However, the remainder had an estimated funding gap of £825 million if an 18-month funding runway is to be achieved and this will need to be filled relatively quickly for many. Existing investors are likely to step up where they are confident of the business model viability, and this funding could be enhanced by government support schemes.

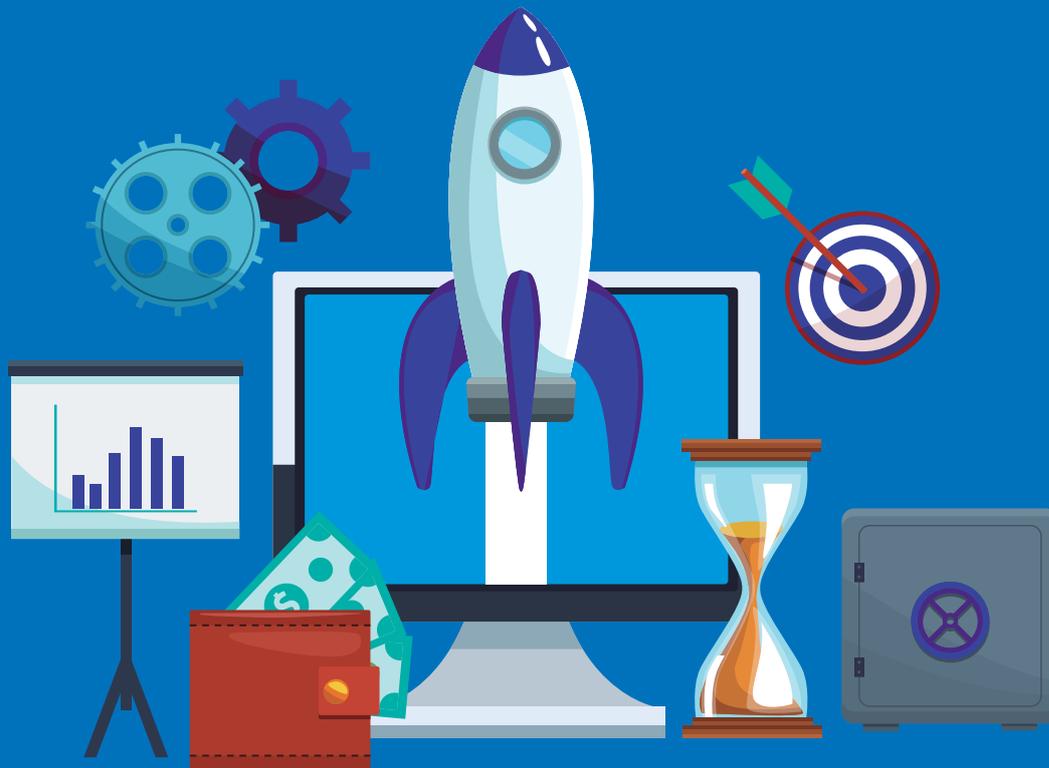
Research Overview

We are tracking the financing, valuation and performance of a growing sample of fintech start-ups in the UK. The sample now comprises 100 companies which have all been founded since 2010 and have had at least 2 rounds of external funding.

Our sample represents a cross-section of fintech verticals (e.g. Paytech, Regtech etc.) and includes several of the major companies in each vertical. It covers a range of businesses within the fintech sector from which we have sought to identify insights and trends. The sample is split into two main categories:

- financial service providers (typically regulated activities) (54)
- technology or processing service providers (46)

Note that there are seven companies in the financial services category which, though primarily providing a service direct to end users, are also providing technology to other companies. Hence, we consider these to be hybrid business models.



Summary Statistics for the Sample



Total equity raised



Total valuation*



Total cumulative losses

Per Company in the Sample	Mean	Median
Equity raised	£53m	£17m
Latest valuation	£187m	£42m
Number of funding rounds	4.8	5.0
Years since first funding round	5.2	4.8
IRR from first to latest round**	94%	71%

* Based on latest round of funding

** Internal rate of return on paper for first round investors based on share prices at first and latest round

Fintech and the Impact of COVID-19

At the time of publishing this report, COVID-19 continues to take its toll on people and businesses in the UK and elsewhere. The fintech sector is not immune. This is the first major disruption that the recent wave of fintech start-ups which emerged after the global financial crisis have had to deal with.

Although there may be a few beneficiaries, most companies face challenges in the short to medium term. There are no firm predictions of when business will get back to normal, or what normal looks like, but many expect it will not be for at least 12 to 18 months.

The UK government has launched various support initiatives for businesses, and more specifically for start-ups. This will enable some to access debt or equity financing which will provide short-term relief, but loans will need to be repaid at some point and equity financing comes with a cost.

Our research distinguishes between fintechs which provide financial services and those which provide technology/processing services and we expect the impact on these to differ:

– **Financial Services businesses**

The impact on these businesses will vary depending on the vertical and market segment they are operating in. Broadly speaking they will be negatively affected by decreasing consumer spending and increasing credit risk but there will also be some opportunities as more activity migrates to digital channels. Any service that is non-essential for consumers or businesses and does not offer clear cost savings is likely to suffer in the short term.

– **Technology/Processing businesses**

The impact on these businesses depends to a large extent on the financial health of their corporate customers – the companies which are deploying the solutions into their own operations. It is possible that many projects in progress will complete and the impact will only be felt in 6 to 12 months if the sales funnel does not refill and budgets are constrained. However, solutions that deliver meaningful cost savings for clients with a short payback will still be in demand.

Looking ahead there will be longer term growth opportunities due to the acceleration towards digital. This can already be seen in some sectors with the increase in working from home and the growth in online shopping. In the meantime, fintech start-ups will come under growing pressure from their investors to demonstrate they have a viable business model and a clear path to profitability, based on realistic assumptions.

// Many companies need financing to fill funding gaps. Raising funding is always a difficult process, even for some of the most promising fintechs, and the crisis has exacerbated the problem. Not only has capital become more challenging to raise, many that do raise have been forced to accept lower valuations.

That being said, raising capital - even at a lower valuation - is still a great achievement in this climate. //

Liam Gray

Head of Fintech programme, Tech Nation

Potential Impact on the Financial Services Businesses in the Fintech Sector

Vertical	Potential impact
Bankingtech	Digital banks and neo-banks will lose out on international payment fees with travel being dramatically reduced. Those starting to do consumer or business lending will find this challenging even with government support. There may be some benefit from consumers using this opportunity to switch from incumbents.
Paytech	The international money transfer and remittance businesses are likely to suffer from falling volumes although the companies focused on digital channels will fare better than branch-based incumbents. Point-of-sale payments and loyalty businesses will also have seen a big drop in volume, but online payments businesses are likely to benefit.
Lendingtech	While government schemes provide the opportunity to make more loans to businesses backed by guarantee, we have already seen a deterioration in credit quality leading to higher provisions at major banks. Marketplace lenders, although they do not take credit risk on their own balances sheets, will also be affected as investors seek to withdraw funds and attractive new lending opportunities are limited.
Insurtech	Insurance for consumers and small businesses may be less directly affected than for example lending, but those companies providing services to freelancers and other gig-economy workers will face challenges. There is also a risk, rightly or wrongly, that insurance will be seen as a discretionary expenditure as budgets are being cut.
Wealthtech	With falling stock markets and tight household budgets, it may be that consumers focus less on longer term wealth management issues such as saving for retirement. Services which help people to save money, such as personal finance apps, may however be in greater demand as people need to make savings and perhaps have more time at home to deal with this.

Effective applications of technology and data by fintech challengers along with their inherent agility mean they are well positioned to respond to the emerging structural opportunities. Incumbent players still control more than 90% of the global market, and many of the financial services giants of tomorrow have yet to emerge.

Tim Levene
CEO, Augmentum Fintech

// London and the UK's fintech sector is not immune to the impact of the pandemic, but it does seem to be weathering the storm.

Recent research by Beauhurst shows that only 1% of fintechs are critically affected and 2% are severely affected by coronavirus. This is low compared to the wider ecosystem, where 17% of high growth companies fall into these categories.

This resilience could be attributed to several factors. Firstly, fintechs' tend to have good access to funding and many have raised funds before lockdown, which has given them the cash reserves to build a sufficient runway. There is also an extensive network and supportive ecosystem for fintech companies in London and the UK, which is invaluable when adapting, resource planning and even re-strategising. In general, tech firms seem to be better configured to respond to adverse climates due to their adaptability, innovative approaches and ability to move into remote working seamlessly.

Last year, \$2.11 billion was invested in London fintech companies across 142 deals, second only to San Francisco. Recent funding announcements by Revolut, Yapily, Thought Machine, iwoca, Onfido and Checkout.com shows the strength of London's fintechs who have become established brands with strong reputations. //

Dhaval Gore

Head of Financial, Business Services & Technology
London & Partners

Performance Trends

Start-ups are expected to lose money in the first several years of operation. However, initial business plans designed to attract investors in our experience typically forecast break-even by Year 5 of operation. The reality is much different as we can see from our sample.

The median annual loss for our sample of companies increases each year and in Year 5 of operation reaches £2.7 million. The mean annual loss at this point is £6.2 million because there is a skewed distribution. For example, one company we track was losing £53 million in its fifth year.

Only six of the companies in our sample were breaking even or profitable as of their latest annual reports. In last year's analysis we found that five companies were achieving this milestone but two of those are now loss making again whereas three others have moved into profitability. 84% of the companies in the sample which had not already failed or been sold reported increasing losses and, furthermore, 79% of companies over five years old reported increasing losses. Progress towards profitability is therefore still quite slow.

Only four of the companies in our sample have gone into administration, an increase from two last year. Of these four companies, three have been able to restructure and keep operating in some form. This is a low failure rate relative to what we would have expected.

A few of the notable cases in terms of financial performance have been:

- OakNorth, the SME lender, reported revenue of £104 million and profit after tax of £50 million in the year to December 2019, which was the 5th year of reporting.
- TransferWise, the international payments business, reported revenue of £179 million and profit after tax of £12 million in the year to March 2019, which was the 8th year of reporting.
- iwoca: the SME marketplace lender, reported revenue of £47 million and profit after tax of £1 million in the year to December 2018, which was the 7th year of reporting.

These cases show what is possible, but they are relatively rare. Investors have been prepared until now to tolerate continuing losses at their portfolio companies as they build scale in terms of number of customers, and in some instances also embark on geographic expansion. This has certainly been the case for some of the digital banks which have incurred substantial losses in their early years of operation. However, even before the latest crisis, there were signs of growing pressure to move faster to break-even. Anne Boden, the founder of Starling Bank, is one industry executive who has recognised this and publicly stated that the bank expected to achieve its first monthly profit by early 2021¹.

There is a noticeable difference between the performance profiles of financial services and technology/processing businesses in the sample. Of the 20 companies reporting revenues in Year 5, there were 7 financial services businesses with revenues greater than £10m (e.g. Revolut, TransferWise), whereas there were no technology/processing businesses at this level. The corollary of this is that losses were much higher for the financial Services businesses at this stage of their development.

¹ The Fintech Times, 17 March 2020

Companies Increasing Losses in Their Latest Financial Reports



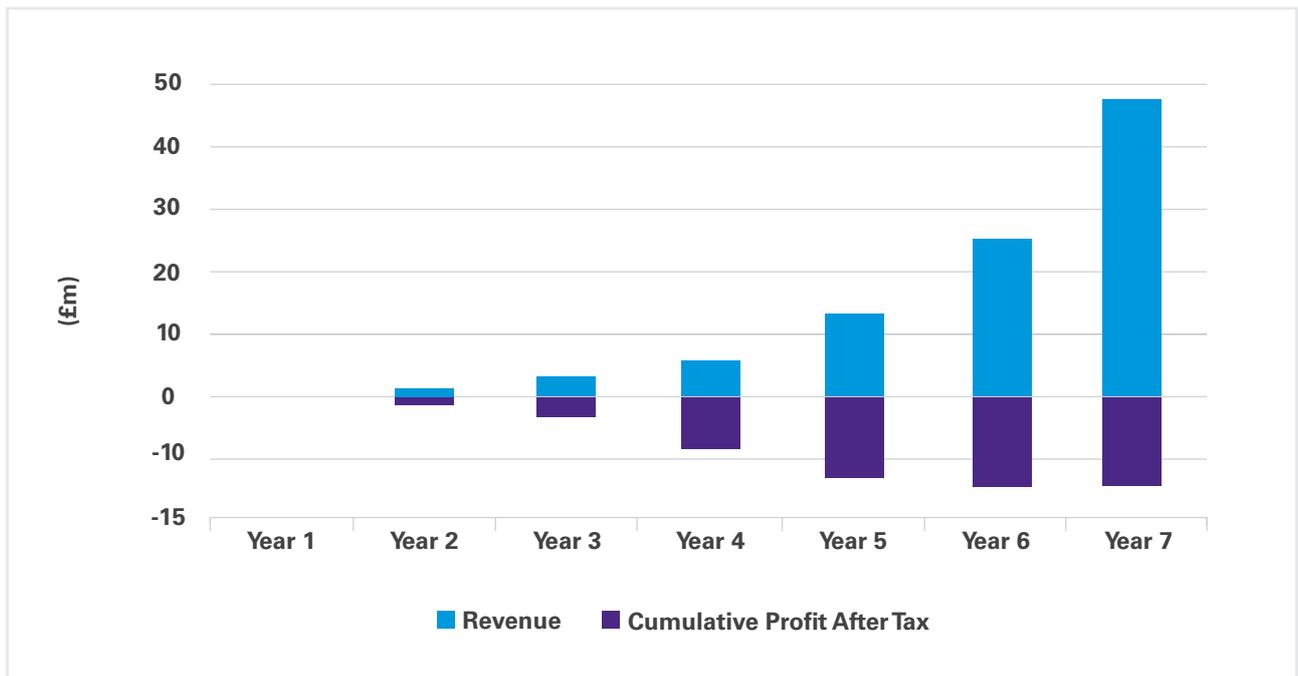
of all companies in sample



of companies > 5 years old

Based on our sample, we have estimated that the annual losses in 2019 for the whole fintech start-up sector (companies founded from 2010 onwards) were in the region of £1.5 billion

iwoca Revenue and Cumulative Profit After Tax



iwoca raised a Series D round of £20 million at the beginning of 2019, bringing total equity financing to £58 million and valuing the company at around £290 million.

The impact of COVID-19 on performance

We have assessed the potential impact on the performance of companies by looking at a couple of cases. One is based on the median profile of a fintech in year 5 of its life, and the other is based on a more successful and developed fintech which is generating substantial revenue and breaking even. These are modelled on the real financials of a selection of companies and show that:

- CASE A: In this case, we have taken the median revenue and profit after tax in Year 5 and then applied a 50% reduction in revenue (and cost of sales), and a compensating 25% reduction in operating costs. The result of this is that annual losses fall from £8.0m to £6.9m.
- CASE B: In this case, we have taken the example of a company with revenues of £100m which is breaking even. Applying the same 50% drop in revenues, and the 25% reduction in costs, the company moves from break even to a loss of £12.5m.

We can see from this analysis that, in fact, having relatively low revenues could mean less of an impact on the bottom line which is already quite negative. Since the majority of fintechs are in this situation, then the immediate impact could be more manageable, as long as some compensating cost savings can be achieved. It does not seem unreasonable to think that a 25% cost reduction is possible, and several options exist, including:

- Hiring freezes (not replacing leavers)
- Furloughing of staff
- Salary or directors' remuneration cuts
- Reduced use of contractors
- Cuts to marketing
- Renegotiation of lease or other contractual terms

Of course, this disruption means that it will take longer for companies to reach break-even, which will have an impact on financing needs and on valuation, something we will look at more closely in the next sections.

// The cyclical need for fintech innovation also reflects the significant Corporate focus in this space. Essentially, financial institutions rely on fintech companies to threaten their businesses, even as they seek to evolve their own services and propositions – it is a form of outsourced R&D. **//**

Ruth Foxe Blader
Partner, Anthemis

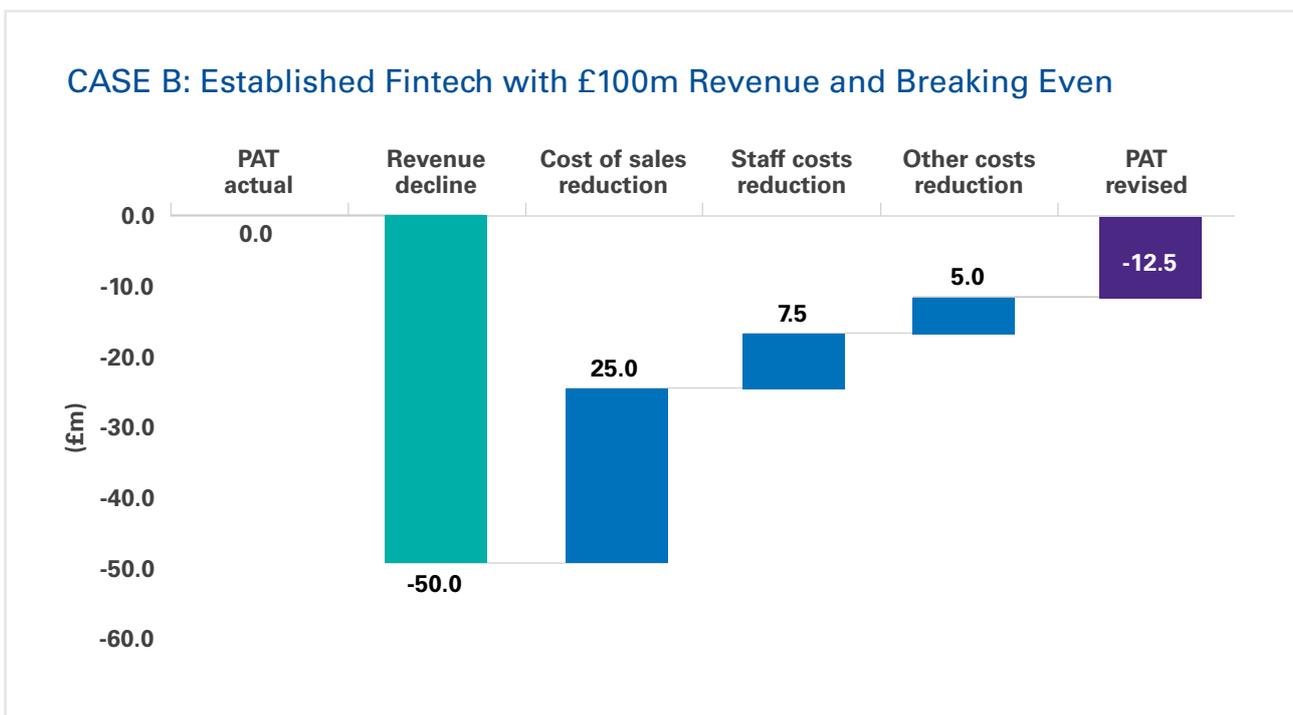
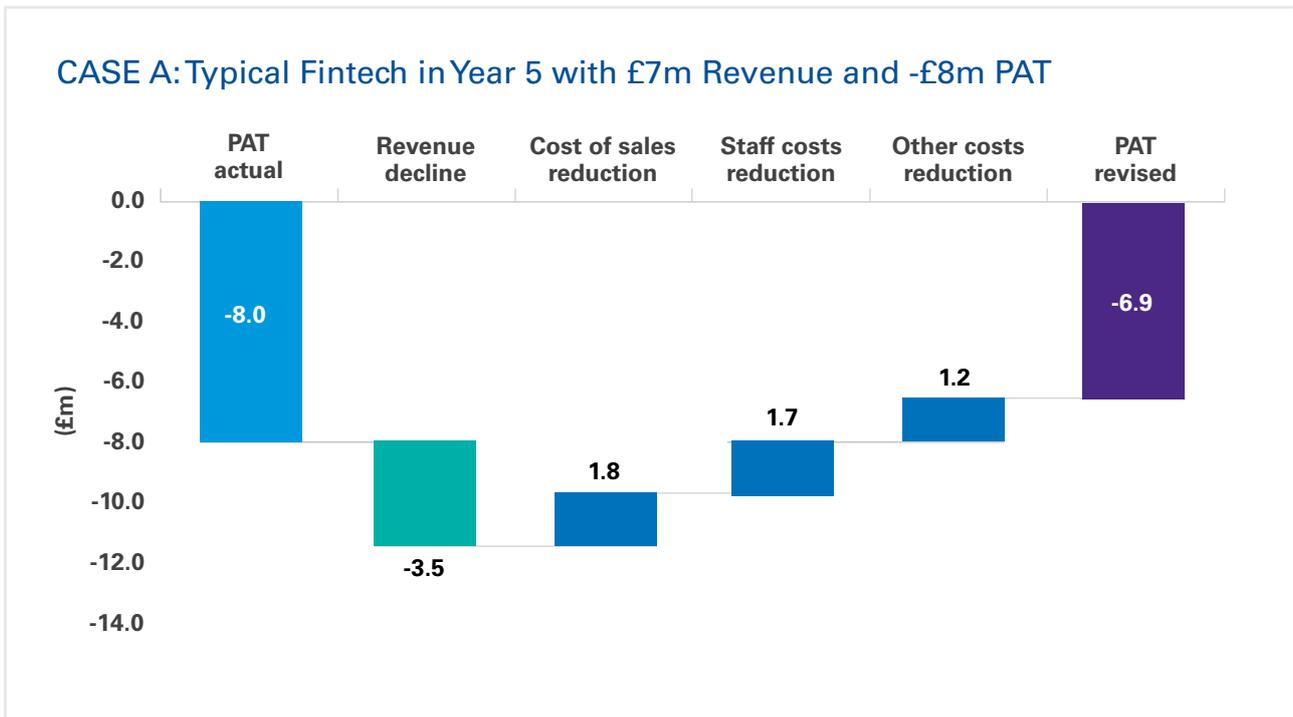
// The last year has seen investment in the fintech sector continue at significant levels, continuing the trend of the previous 12 months. Although it is likely that in retrospect the growth will be interrupted by the effects on the economy of COVID-19 both funding and valuations will remain competitive for those many fintechs thriving under what will become the “new normal”.

As a consequence of the pandemic accelerating the pace of digital adoption, the opportunity for fintech to capitalise on the shift in consumer and business behaviour as a result of COVID-19 has expanded. //

Tim Levene
CEO, Augmentum Fintech

Indicative Impact on Profit After Tax for Two Sample Cases

50% reduction in revenue and cost of sales
 25% reduction in staff and other costs



Financing Trends

Financing for fintech start-ups has continued at a high level in 2019 and into 2020. According to KPMG's analysis for Pulse of Fintech, venture capital investment, private equity investment and M&A in the sector in the UK was £38.4 billion in 2019, an increase from £20.1 billion in 2018.

What is noticeable from our sample and from the overall industry data is the concentration of this funding in a small number of cases. The sample companies raised £1.1 billion of equity finance in the year to 31st March 2020 and 70% of this was due to 5 companies. The average funds raised per company was £27 million but the median was just £7 million, which illustrates the skewed distribution.

Again, there was a clear difference between financial services and technology/processing businesses. The average amount raised by the former was £38 million and by the latter was £12 million. The four largest raises were by financial Services companies, led by Revolut which raised £385 million, followed by World Remit which raised £137 million.

Typically, the Technology/Processing business have not required as much funding as the consumer facing businesses such as Revolut which are trying to build global scale. However, there were a couple of notable recent announcements which were made in April 2020:

- Onfido, which provides digital onboarding solutions, had raised £34 million at a valuation of c£112 million up to the end of March 2020, but announced a further £80 million of funding in April 2020.
- Privitar, which provides software for enterprise-wide privacy protection, had raised £50 million at a valuation of c£117 million up to the end of March 2020, but announced a further £64 million of funding in April 2020.

These are examples of companies which may not be as negatively affected by the COVID-19 crisis as others in the sector, if at all. Demand for digital ID solutions is likely to grow, and there is a continuing need for data privacy solutions.

² "Pulse of Fintech H2 2019"; KPMG, February 2020

One of the features of the development of the sector has been that loss-making companies have stayed private for a relatively long time and been able to continue raising funds. Our analysis of the funding rounds completed by our sample companies in the year to 31st March 2020 illustrates some of these features:

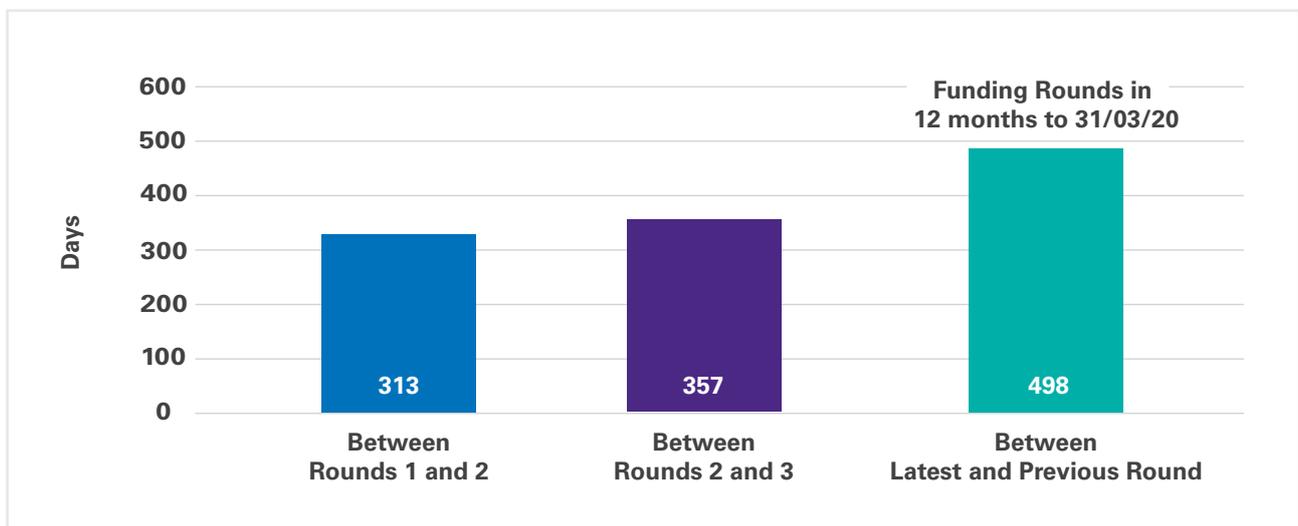
- For companies raising in their first four years (measured from the date of the first external funding round), 93% increased the size of the funding round relative to the previous round and increased the share price for the round on average by 131% relative to the previous round.
- For companies raising in their 5th year or later, only 55% increased the round size from the previous round, but with an increase in share price of 106% on average. For the older companies which did not increase their round size, the average increase in share price was only 7%.

We can also see from this year's analysis that the time between funding rounds is increasing. The data shows that in the first few rounds of funding, the gap between rounds is between 300 and 350 days, less than one year. However, for the funding rounds recorded in the past 12 months by our sample companies, the days between funding rounds has increased to nearly 500 days.

Profile of Funding Rounds in the 12 Months to 31/03/20

Years of Fund Raising		Proportion of Sample	Mean Price Increase
Years 1-4	Increase in round size	93%	131%
	Decrease in round size	7%	41%
Years 5 or more	Increase in round size	55%	106%
	Decrease in round size	45%	7%

Median Days Between Funding Rounds



// As cash becomes the true scarce resource, reinforcing economics needs to be paired with active cash preservation strategies. Containing the cost base has been the immediate reaction across the industry - but with limited number of months of cash at hand (and expectations from investors to reforecast longer runways in case the crisis lengthens or evolves into unforeseen ways), startups have felt the need to be more creative around securing cash availability.

This has drastically changed the dynamics between CEOs and existing investors, as all have had to work closer together than before and show extra levels of creativity to juggle resource allocation and availability and business priorities under extreme uncertainty. //

Manuel Silva

Partner and Head of Investments, Santander InnoVentures

The impact of COVID-19 on financing

The data shows, and we know from observation, that most start-ups are in a continuous fund-raising cycle. Once a round has been completed, founders are already thinking and planning for the next round. A typical start-up probably needs 18 months of “runway” to be confident of its financial position if there are delays in executing the next round.

We have therefore tried to estimate the funding position of our sample of companies based on:

- Shareholders’ equity at the last annual report
- The run rate of losses at the last annual report extrapolated to 31st March 2020
- The funding that has been reported or announced up to 31st March 2020

Shareholders’ equity for most of the companies in the sample tends to be the share premium less retained earnings as there are not normally any other reserves. Net profit after tax is a reasonable though not perfect indicator of operating cash flow because capital expenditure tends to be low for fintech companies, and trade debtors and creditors are not a big factor when revenues are relatively low.

An illustration of the calculation is shown for one company in the chart on the opposite page. This company had equity of £15 million at 31st December 2018 and we have extrapolated that to be just £1 million at 31st March 2020. Given the annual rate of losses, and assuming no change, the company has enough equity to cover 4 months of losses, which we describe as the “headroom”.

What we find is that, going into the crisis at the beginning of April, only just over half of companies had more than 18 months of funding headroom. As the chart opposite shows, around 23% of companies were already in a negative equity position and another 9% had less than 6 months of runway. The companies in a negative equity position will probably already have been using short-term funding sources to bolster their balance sheets or possibly completed unannounced funding rounds (though this is rare).

Various options for further funding exist such as:

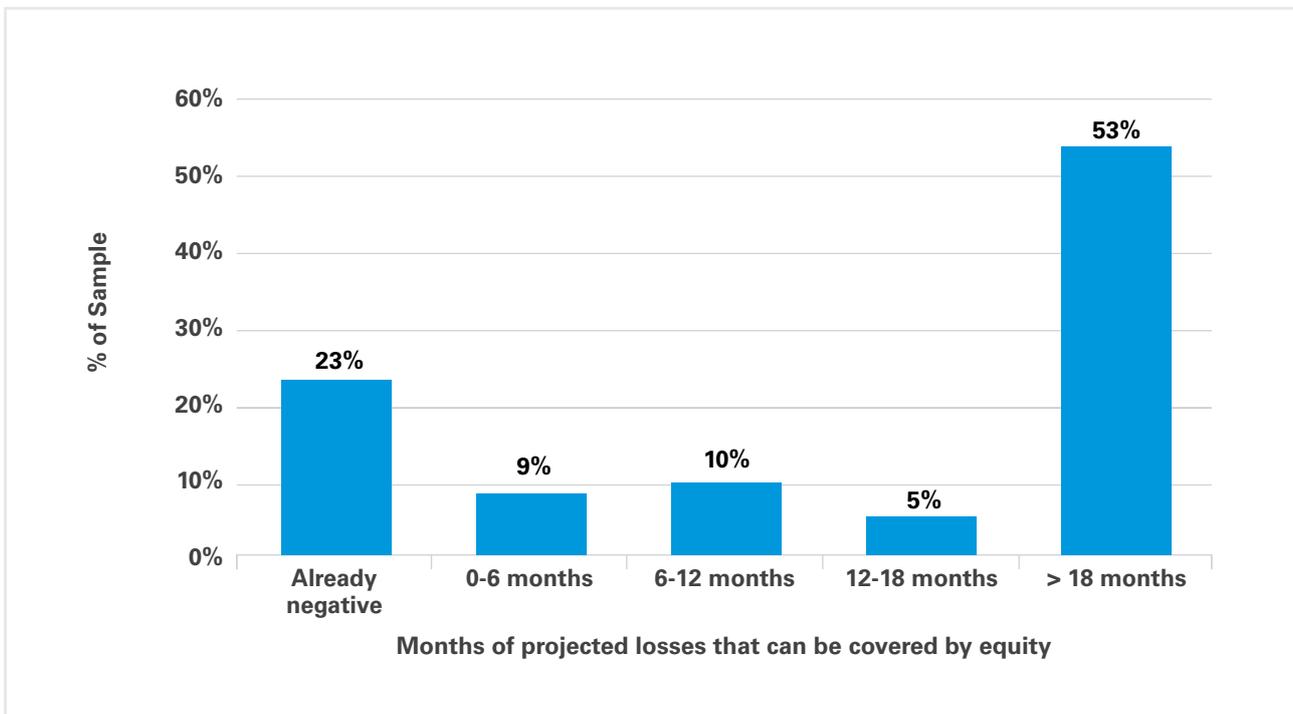
- Bank loans
- Venture debt
- Convertible loans
- Equity

Relatively few companies can get bank loans or venture debt – just 10-15% of our sample leading up to the crisis. Existing or new investors, plus the government scheme may be able to provide convertible loans or equity. Companies that have had only one round of funding from angel investors could be more at risk compared to companies which have already taken finance from venture capital firms or corporate investors.

Illustration of the Funding “Headroom” Calculation



Analysis of the Funding “Headroom” for the Sample Companies



Valuation Trends

Across our sample the median Internal Rate of Return for first round investors is currently 71%, calculated by comparing the price at which shares were issued in the first round of investment to the price in the latest round of investment.

Only a few cases have a negative IRR due to failure or down rounds. The majority are in the range 0% to 100%. However, there are some significant outliers with very high IRRs on paper, for example:

- Revolut and Monzo have both had funding rounds in the past 12 months and achieved very high IRRs on paper at 220% and 193% respectively, supported by their success in gaining large numbers of customers. Note that both these companies have crowdfunding investors as well, providing a boost to the perceived performance of that funding mechanism.
- Of the Technology/Processing businesses which have received funding recently, TrueLayer stands out having achieved an IRR of 117% for its first round investors. The valuation of this open banking technology company has possibly benefited from the success of the U.S. start-up Plaid, founded in 2012, which was acquired by Visa for US\$5.3 billion in January 2020.
- A total of four companies in the sample have entered administration and down rounds have been relatively rare. Only four companies had a down round in their last funding round. Interestingly, two of these companies executed a strategy pivot moving from a B2C business model to a B2B business model and time will tell if this has paid off.

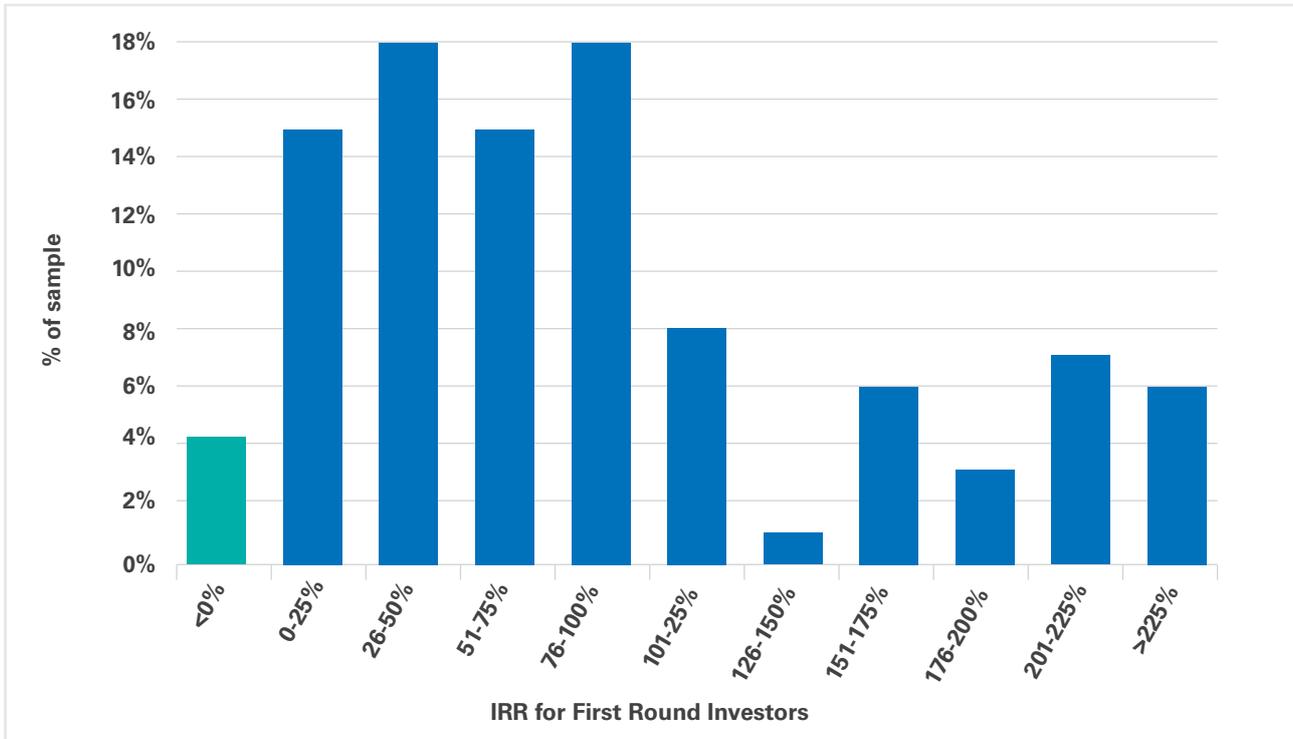
We noted in last year's report that IRRs decline as companies get older and returns on paper for later round investors are much smaller. Based on this historical data, we predicted what the IRRs should have been for the funding rounds in the past 12 months and found that they were somewhat lower than expected. This can be seen in the following chart which shows the actual and predicted IRRs for first round investors in recent funding rounds. The result was similar for both financial Services and technology/processing businesses raising funds.

// Investor priorities over much of the first half of 2020 have been as much about supporting existing investments as they have about sourcing new opportunities, with a focus on ensuring investee companies are “match-fit” for the future.

For those continuing to invest there has been a preference for strong unit economics and balance sheets. Valuations have been impacted, however we believe these are likely to rebound in the second half of 2020. //

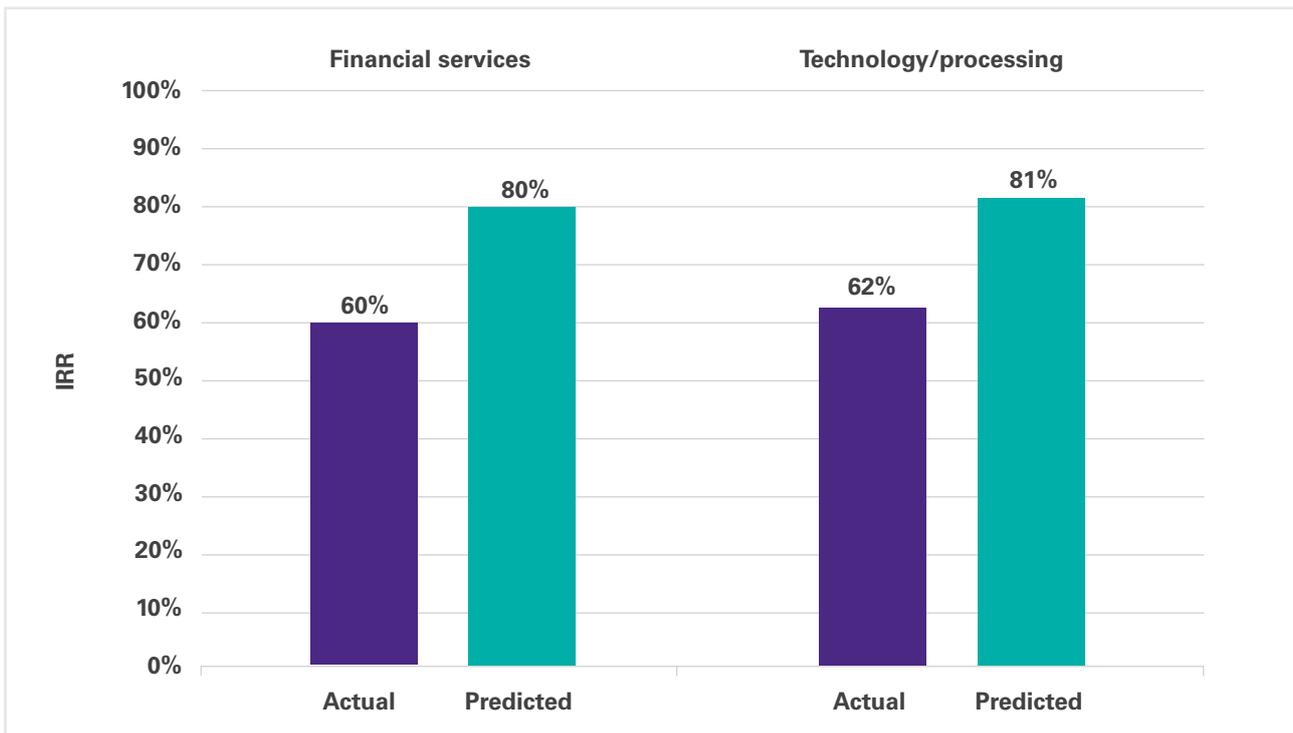
Tim Levene
CEO, Augmentum Fintech

Distribution of IRRs First Round Investors



Note: Excludes one case which emerged from administration and impact on investors unclear

IRRs for First Round Investors in Recent Funding Rounds



// We need to refocus on unit economics as investors, not just profitable businesses. The business case that supports these types of firms are miraculous if they make sense but not as easy to fund. That is because heterogeneity is the rule of the day. Therefore the whole valuation dialogue is a hot topic and becomes a discussion about how the founder will take market share? This will become a more distinct conversation now – as opposed to the last four years – particularly for the early stage or late stage investor.

Linked to that, certain classes of fintech are getting stale as they age and investors will be asking themselves about the exit opportunity in this space. Is it as big as other technology companies outside of the fintech sector? Fintech could become an awkward space as VC investors question returns and doing repeatable business. As a result, some Ventures might chose to bootstrap or work more with CVCs. //

Ruth Foxe Blader
Partner, Anthemis

The impact of COVID-19 on valuation

Where companies can raise funds from existing investors, it is possible that valuations will be maintained at least at the same level as the most recent round of funding. Alternatively, a convertible loan structure may be used as a more flexible option – a conversion valuation can be agreed but the loans could be repaid rather than converted to equity if funds can be raised at a higher valuation in the future.

It will be more challenging if a business needs to find funds from new investors. We have illustrated the impact of a down round on the typical fintech in the charts opposite. The median share price progression over the first 4 rounds is shown, rising from an indexed level of 100 to 500, around three years after the first funding round. A down round of 25 percent for Round 5 would move the price back to an indexed level of 375, which would still be above the price paid by investors at Round 3.

The impact of this on the IRR for each set of investors is shown in the other chart opposite which compares the IRR at Round 4 to the new IRR at Round 5 with a 25% lower share price:

- For Round 1 investors, the IRR will fall from 80% to 38%
- For Round 2 investors, the IRR will fall from 61% to 21%
- For Round 3 investors, the IRR will fall from 45% to 2%
- For Round 4 investors, the IRR at this new round will be -19%

In many cases, investors have participated in more than one round, so Round 4 investors may also have been Round 2 or Round 3 investors etc. Hence, the net impact on their holdings will be a weighted average of these figures.

One investor group that may be more negatively affected by a down round than others is corporate investors. Typically, across our sample, they have been investing in Rounds 3 and 4, although there are some cases of corporates investing in Rounds 1 and 2. Therefore, the impact of a down round on the IRR on paper for their holdings could be more significant than for angels or for venture capital investors.

Even if valuations can be maintained, any new investors are likely to seek to build into the investment terms some future downside protection in the event of another down round, or an exit at a price below the price at which they invested.

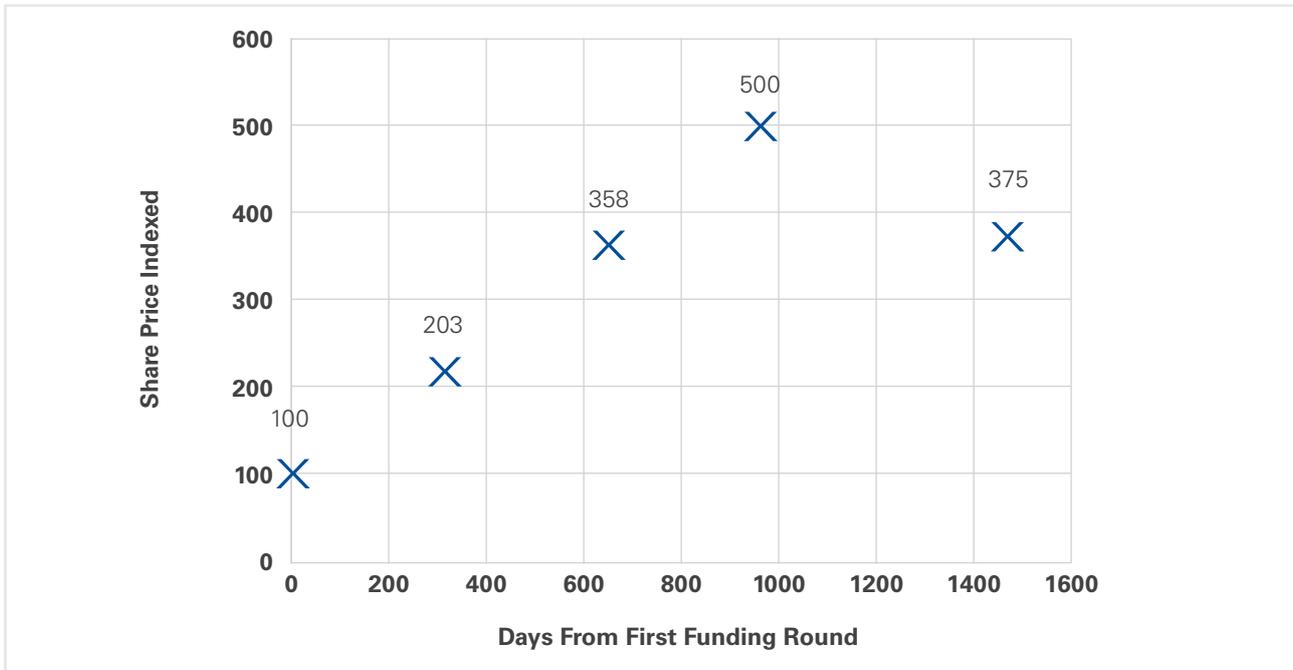
// The current Covid crisis has brought a somewhat abrupt response to the “scale vs. economics” debate. As tech businesses have had to refocus on resilience, reinforcing unit economics have become the absolute priority in the boardroom. Growth for the sake of growth has been relegated to a secondary position, under the tacit assumption that the crisis may reduce competition, and that scale will be easier to build once the worst of the storm is over. **//**

Manuel Silva

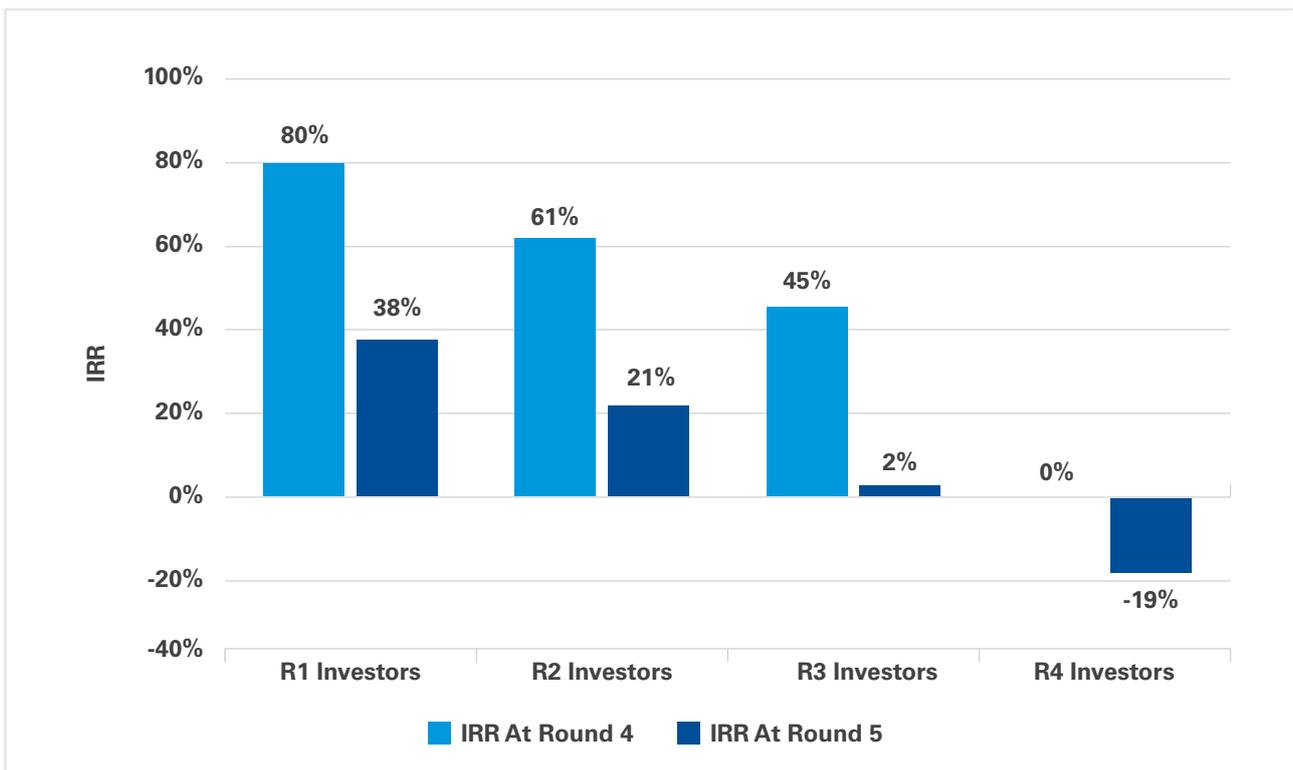
Partner and Head of Investments, Santander InnoVentures

Indexed Share Price at Successive Funding Rounds

Median share price in Rounds 1-4 and assuming a 25% share price reduction in Round 5



Impact of 25% Down Round on IRR for Investors



A Sector and Vertical Comparison

We have already noted in other sections of the report some differences between the financial services and technology/processing sectors within fintech. Sometimes these are also referred to as B2C and B2B though some businesses have B2B2C models and some businesses have hybrid B2C and B2B models so there are a few grey areas.

The key differences are:

- The financial services sector data is skewed by some large companies which have raised significant amounts at high valuations, hence the mean data for the sector on these measures varies more than the median when compared to the technology/processing sector.
- This skewed distribution is also a factor when comparing the IRRs for first round investors as the median figures for the two sectors are very similar, but the mean is quite different. This indicates that some of the financial services sector deals are particularly highly valued.
- The number of employees per company is 50% higher for the financial services businesses than the technology/processing businesses, even on the median measure which is perhaps not surprising. Note that not all employees are based in the UK, but most will be.

Overall, we see relatively little difference to date in the median IRRs for financial services and technology/Processing businesses. However, the Paytech vertical (which includes a mixture of both) stands out from the other verticals in having a high average IRR for first round investors – a median of 98% and a mean of 133%. This vertical in our sample is made up of several different types of business e.g.:

- International money transfers and remittances
- Payments cards
- Payments processing
- Open banking/payments infrastructure

In each of these sub-sectors of payments, valuations have been supported by high public market valuations and deal activity, such as the acquisition of WorldFirst by Ant Financial and the acquisition of Plaid by Visa.

The largest financing transactions for our sample of companies in the past 12 months highlights some particular areas of investor interest:

- Sectors where significant progress has been made in terms of customer numbers continue to be of interest to investors, particularly in digital banking.
- Services building on the development of open banking, such as at ClearBank and TrueLayer are getting some traction supported by deal valuations elsewhere.
- Sectors supported by underlying market growth dynamics such as the growth in the gig-economy and freelance workers.

Regtech is also a vertical worth mentioning. Typically, these companies do not require as much funding as, for example, digital banks and although only Privitar features on our top 10 list, we noted earlier in the report both Privitar and Onfido have announced very large funding rounds in April 2020 (£50m and £80m respectively). The median IRR for first round investors in the Regtech companies in our sample has been 88%, the second highest vertical behind Paytech.

A Comparison of Key Statistics by Sector

Per Company in the Sample	Financial Services		Technology/Processing	
	Mean	Median	Mean	Median
Equity raised	£69m	£18m	£22m	£16m
Latest valuation	£255m	£40m	£61m	£41m
Number of funding rounds	5.5	5.0	4.2	4.0
Cumulative losses	£24m	£7m	£11m	£7m
IRR from first to latest round	104%	73%	83%	70%
Employees	139	49	50	33

10 Largest Fundraising Cases in the Sample in the 12 Months to 31/03/20

Company	Vertical	Amount Raised £m
Revolut	Bankingtech	385
World Remit	Paytech	137
Monzo	Bankingtech	113
Starling	Bankingtech	54
Atom Bank	Bankingtech	50
Privitar	Regtech	32
ClearBank	Bankingtech	30
TrueLayer	Paytech	27
Receipt Bank	Other	25
Zego	Insurtech	22

Some Observations from Financing Cases in the Past 12 Months

Vertical	Observations
Bankingtech	Large funding rounds for Revolut, Monzo, Starling, Atom and ClearBank highlight interest in the sector and the need for significant investment.
Lendingtech	Sonovate, which finances the payments to contractors by temp recruiters, did not make it to the top 10 list but was the largest funding in the vertical.
Paytech	Large funding round for World Remit in its 10th year of fundraising, and also for TrueLayer with strong interest in open banking.
Insurtech	Zego was the largest fund raiser within our sample demonstrating the interest in services for freelancers / gig-economy workers.
Wealthtech	SmartPension did not make it to the Top 10 list but raised another large round with growing demand for B2B employee pension management services.
Regtech	Privitar raised a large round for data privacy solutions which was followed by another round announced in April 2020.

There are specific sectors and technologies that we think will strengthen post-lockdown such as regtech, insurtech and wealth management, with an increased emphasis on partnerships. In addition, demand for cyber security and digital process automation will also ramp up.

London is a natural home for fintech due to its position as a global financial centre alongside its deep technology talent pool, supportive regulation and an early-adopting customer-base. These fundamental strengths will continue to help fintech companies through the pandemic and towards recovery. The city's extensive investor network – including a growing number from overseas – will also mean that London's fintech sector is well positioned for the recovery phase.

Dhaval Gore
 Head of Financial, Business Services & Technology
 London & Partners

Methodology and Research Notes

The data for this report has been compiled from regulatory filings at Companies House in the UK. All limited companies are required to file annual financial statements (full or abridged), an annual statement of share capital and shareholdings, and details of any share issues made. We have not sought to confirm the completeness and accuracy of the information contained within the filings and it should be noted that filings at Companies House are not consistently subject to independent review or inspection.

Due to the private nature of many of these companies, the information contained within their annual financial statements is not always consistent and often not of the same level of disclosure as a company which is subject to various transparency disclosure and reporting standards such as the UK Code of Corporate Governance.

The data which is submitted to Companies House is not necessarily consistent with what might be found in the media. Data included in our analysis is solely from the statutory filings with Companies House unless stated otherwise and were extracted up to 31 March 2020.

In some parts of the report we refer to averages (mean or median). These figures need to be taken in context, depending on the measure. We think that for some of the measures these averages can provide useful insight but bear in mind there are always outliers.

Where we refer to valuation, this is the “on paper” valuation which is recorded at each round of funding based on the price at which shares are issued to investors.

In some cases, it is not entirely clear what is a separate funding round so we have used judgement where necessary to define a funding round. In other cases, the share issues for a round take place over several months so we take the earliest issue date for that round, or the date on which the majority of shares were issued in that round.

The data has some limitations. For example, each company will have share option plans which will likely dilute the shareholdings of investors at different points in time depending on performance. Share classes can also have different terms which may favour some share classes on exit or in the case of a down valuation. This is too complex for us to model in the research, but we believe that our general conclusions are still valid.

Acknowledgements:

Augmentum Fintech plc

Augmentum invests in fast growing fintech businesses that are disrupting the financial services sector.

Augmentum is the UK's only publicly listed investment company focusing on the fintech sector in the UK and wider Europe, giving businesses access to patient capital and support, unrestricted by conventional fund timelines and giving public markets investors access to a largely privately held investment sector during its main period of growth. Their portfolio of 18 fintech companies includes Tide, interactive investor, Onfido, BullionVault and Farewill.

Anthemis

Anthemis Group is a venture capital firm investing in retail banking and consumer finance, business and corporate banking, payments, wealth and asset management, and capital markets, as well as investment management and advisory services.

The group has a diversified portfolio of best-in-class, high-growth, digitally native financial services companies based around the world. Anthemis are thesis-driven investors and hold several vehicles in which they invest discretionary and non-discretionary capital across a wide range of companies, from early stage to growth.

London & Partners

London & Partners is London's international trade, investment and promotion agency. Its purpose is to support the Mayor's priorities by promoting London as the best city in the world in which to invest, work, study and visit. They do this by devising creative ways to promote London and to amplify the Mayor's messages, priorities and campaigns.

London & Partners is a not-for-profit public private partnership, funded by the Mayor of London and a network of commercial partners.

Santander InnoVentures

Santander InnoVentures is Santander Group's corporate venture capital fund. It invests in fintech startups and adjacent verticals to accelerate their growth, helping entrepreneurs and their teams, and supporting them with capital, scale and Santander's expertise.

Since launching in 2014, InnoVentures has invested in over 30 companies, making it one of the most active bank-backed fintech corporate ventures in the world.

Tech Nation

Tech Nation fuels the growth of game-changing founders, leaders and scaling companies so they can positively transform societies and economies, providing them with the coaching, content and community needed for their journey in designing the future.

Over the past five years, the programmes have engaged with nearly 2,000 businesses and since the first Future Fifty cohort have generated more than £65m GVA for the UK economy.

Innovate Finance

Innovate Finance an independent industry body that represents and advances the global fintech community in the UK. Our mission is to accelerate the UK's leading role in the financial services sector by directly supporting the next generation of technology-led innovators.

Membership ranges from seed stage startups and global financial institutions to investors, professional services firms and global fintech hubs. All benefit from Innovate Finance's unique position as the single point of access to promote policy and regulation, talent and skills, business opportunity and growth, and investment capital.

// We expect to see increased rates of M&A activity over the next twelve months, with opportunistic and strategic acquisitions sought both by incumbents transitioning to more digital offerings as well as by well-funded challengers seeking scale. The trend of technology companies staying private for longer, a result of the availability of capital and attractive M&A opportunities amongst other reasons, is likely to be strengthened further in light of public market volatility. //

Tim Levene
CEO, Augmentum Fintech

Points of Contact

KPMG in the UK



Anton Ruddenklau

Global Co-Leader for Fintech

T: +44 (0) 7467 339 709

E: anton.ruddenklau@kpmg.co.uk



Joe Cassidy

Partner & Head of Market Infrastructure

T: +44 (0)20 7694 1525

E: joe.cassidy@kpmg.co.uk



Jeremy Welch

Partner, Deal Advisory

T: +44 (0) 7969 251 040

E: jeremy.welch@kpmg.co.uk



Paddy Goodlet

UK Fintech M&A Lead, Corporate Finance

T: +44 (0) 7785 574 951

E: paddy.goodlet@kpmg.co.uk



Ed Boyle

Partner, Restructuring Partner

T: +44 (0) 7799 132 604

E: ed.boyle@kpmg.co.uk



Hannah Dobson

Partner, National Markets

T: +44 (0) 7798 694 970

E: hannah.dobson@kpmg.co.uk

Google



Matthew Yeager

Google Cloud - Digital Natives UKI

T: +44 (0)20 3820 8387

E: mpyeager@google.com

Author



Michael Pearson

Clarus Investments

T: +44 (0) 7901 670 899

E: michael@clarusinvestments.com



kpmg.com/uk/fintechfocus

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2020 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Designed by **CREATE.** | July 2020 | CRT127587