

# FAIRVIEW

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## **FINANCIAL TECHNOLOGY: FINTECH PRIMER** INDUSTRY OVERVIEW FROM A VENTURE CAPITAL PERSPECTIVE

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## **Introduction**

Financial Technology (FinTech) is an application of business process outsourcing (BPO). This specific form of outsourcing involves the creation of software and other technological processes that allow an organization to streamline financial operations, either customer-facing or back office, as well as improve operational performance. FinTech companies provide a wide range of finance related software and processes for companies such as decision support, risk management, portfolio rebalancing, compliance, performance attribution, systems integration, and electronic transfers and payments. FinTech enables companies to gain the best-in-class methodologies without requiring organizations to devote additional internal technological resources or personnel. Many of these solutions reduce costs, while dramatically improving service levels.

Ever changing trends in the economy, aggressive demands from customers, and continuous regulatory changes have increased competitive pressure for companies. Companies must seek to lower costs, improve productivity and increase profits while complying with constantly evolving regulations. FinTech gives companies the ability to outsource value-added, customer-centric functions while reducing investments in operations. Originally, the BPO model was used specifically for information technology services but has expanded to include human resources, administrative, finance and accounting functions. These are all areas that are amenable to innovation in FinTech.

## **Industry Overview**

### **Market Drivers**

Oversight and regulation of companies has recently become more stringent because of disasters such as the collapse of major banks and the fraudulent activities of some investment firms. Much of the oversight relates to capital liquidity, security, reporting and financial controls. The introduction of regulatory enforcements like Sarbanes Oxley and Basel II has also added complexity to financial reporting and analysis. Regulators will continue to want to see more transparency with regards to compliance and reporting. FinTech companies have the opportunity to create new and improved solutions to address these pressing issues.

Many companies will seek to utilize financial technology tools to improve profitability and streamline processes. Companies looking to realize these improvements must do this by either utilizing in-house resources or using FinTech providers. Utilizing FinTech providers allows companies to realize efficiencies not by having to own the technology, but rather by outsourcing.

## Classification

FinTech applications and services can be classified into four groups (Figure 1):

- Customer Service: processes and services that deal with the customer at the user interface level as well as at the back end database level
- Financial Service: applications and processes for portfolio management and risk management
- Compliance: methods for a company to comply with regulations
- Business Processes: technology a company uses to maintain and access critical information and data

Figure 1 – FinTech Services

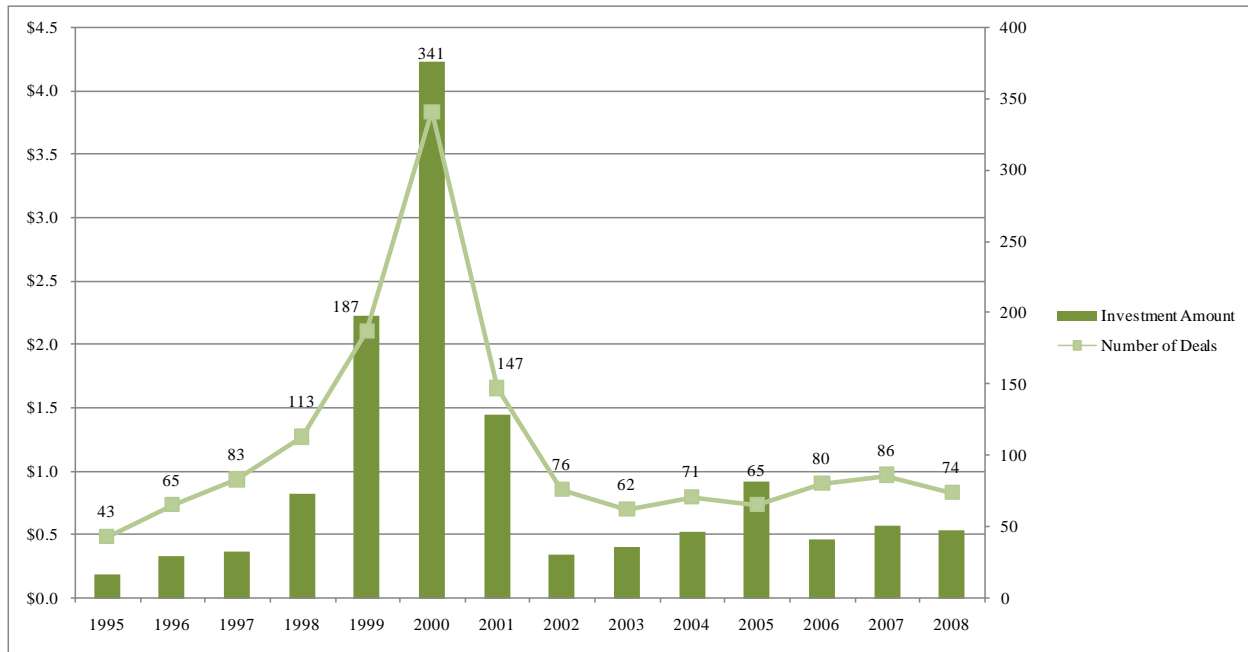


## Venture Activity

The market for financial BPO is currently estimated at \$15 billion and is expected to grow 10% per year to a \$25 billion market in five years. This robust growth represents an attractive opportunity for innovators and entrepreneurs in FinTech. Recently, there has been venture activity across all four FinTech groups including electronic billing, payment and banking in customer service; portfolio and asset management in financial service; financial statement reporting and analysis in compliance; and document management and imaging software in business processes.

Since 1995, venture capital investment in financial services (a proxy for FinTech) increased significantly from 43 deals in 1995 to 341 deals in 2000 as a result of the dotcom boom. After this peak in 2000, the number of venture deals in FinTech has come down and has been relatively stable since 2002 with 74 deals in 2008 (Figure 2).

Figure 2 – Venture Capital Activity in Financial Services



Note: All dollar values are in billions

Source: PricewaterhouseCoopers/National Venture Capital Association MoneyTree(tm) Report

Definition of Financial Services via Money Tree Report: Providers of financial services to other businesses or individuals including banking, real estate, brokerage services, and financial planning.

## Notable Exits

Historically, several partnerships in Fairview's portfolio have realized significant returns from FinTech investments including the following:



- Ameritrade Holding Corporation provides a dynamic balance of online investment products and services that make it a choice for millions of retail investors and independent registered investment advisor companies. The investment resulted in a 6.2x multiple upon exit.



- BillMatrix Corporation provides comprehensive electronic payment services for clients nationwide. Online bill payments or phone payments made using BillMatrix are secure, fast and offer customer convenience. The investment resulted in a 7.6x return upon exit.



- GMT Group is a leading global provider of electronic money transfer services. The company is the largest privately-owned company in the dynamic money transfer industry and the second largest provider of money transfer services to the \$40 billion US-to-Latin American and Caribbean market segment. The investment resulted in a 5.0x return upon exit.



- Intercontinental Exchange is an integrated electronic platform for side-by-side trading of energy futures. Through its electronic trading platform, the company's marketplace brings together buyers and sellers of derivative and physical commodities, financial contracts and its participants to optimize their trading, risk management and hedging operations. The investment resulted in a 10.1x multiple upon exit.

## **The Future of FinTech**

In the wake of the 2008 financial market meltdown, changes in the economy have sparked the beginning of a permanent restructuring of the financial services industry. Increased regulatory oversight is certain, and the Obama administration intends to make large-scale changes to financial services that they hope will dramatically reduce long term risk. We anticipate this will result in tremendous opportunities for compliance software and services, thereby increasing venture investment options in FinTech. These opportunities will challenge FinTech vendors to create new and improved solutions that are differentiated from competitors, but also value-added for clients.

Financial institutions are some of the most sophisticated users of technology, and given the increased complexity of financial products, this phenomenon will likely continue in the future. We expect the growth in FinTech to be vast. Many small FinTech firms are taking advantage of growth opportunities due to increased demand for their service offerings. We are excited about the adoption of technologies that support robust financial processes and value-added capability to financial services companies, and look forward to continuing our investment in FinTech as we expect the demand for these services to increase.