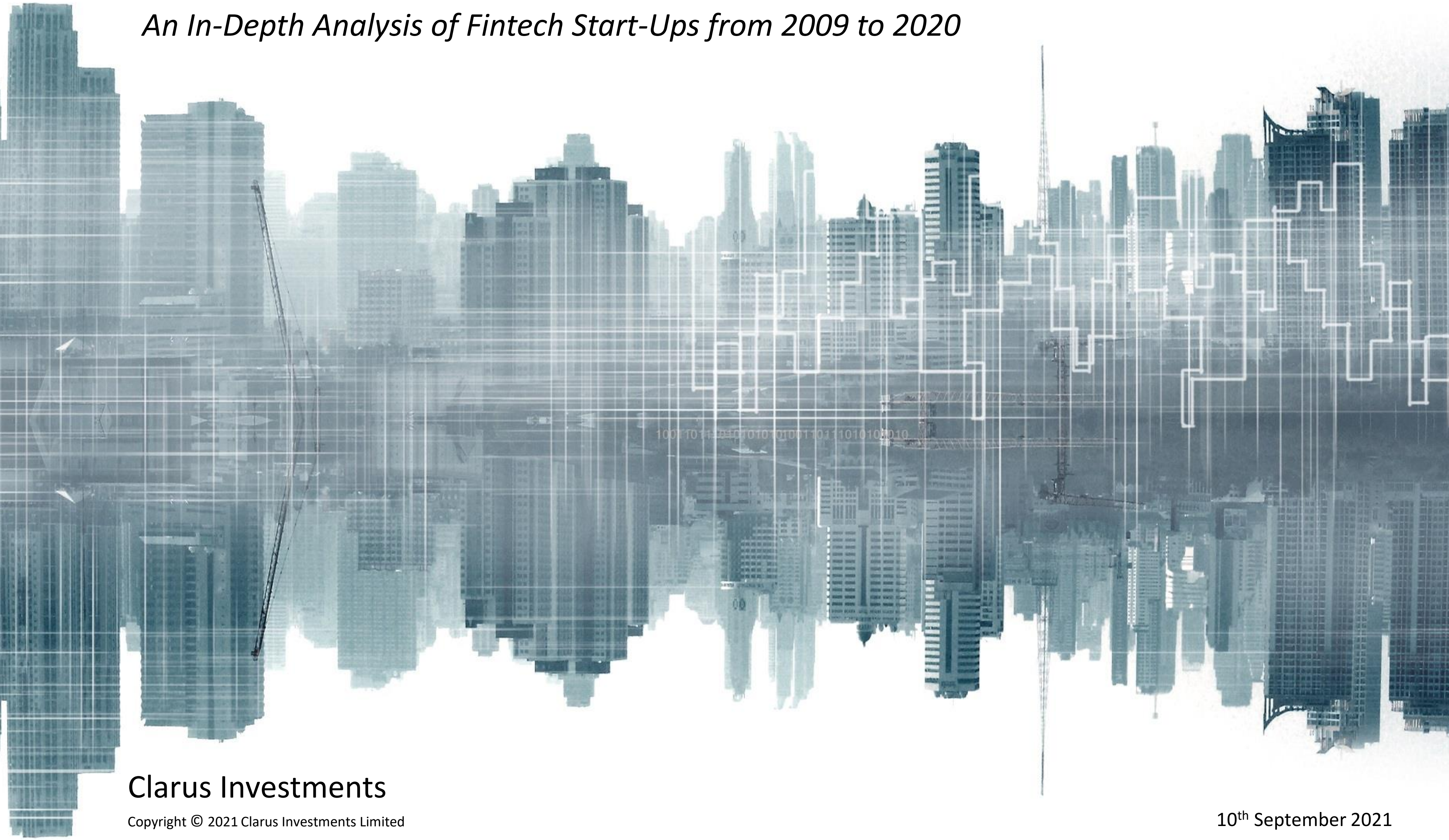
The UK Fintech Sector

An In-Depth Analysis of Fintech Start-Ups from 2009 to 2020



Clarus Investments

10th September 2021

Foreword

The UK has a dynamic Fintech sector including many older companies which have been operating successfully for years. However, there has been a surge of start-ups since the global financial crisis in 2008-09 and it is these companies which are the focus of our research at Clarus Investments.

The equity financing of Fintech start-ups in the UK exceeds £11bn in the period 2009 to 2020, and 2021 is already on track to be a record year for fund raising. At the same time, valuations for some companies have increased substantially in the past 12 months, and there have been a few notable recent exits for investors.

The returns on paper for early stage investors in Fintech have been very high, even allowing for failures. However, we know that not all venture capital funded companies will survive and relatively few will be a long term success – probably only around 10% to 20%. That means, of the just over 1,000 companies started since 2009 and receiving at least one round of funding, perhaps 150 will create any meaningful value and we should not be surprised if the others disappear.

There are indications that the rate of new innovation is slowing as investment in early stage rounds and the number of companies founded are now declining. The focus of investors has moved to investing in those companies with some traction which are expected to be big winners. Such companies are getting large funding rounds at very high valuations. Perhaps the best example is Revolut which raised over £550m in July 2021 at a reported valuation of £24bn.

The Fintech sector comprises many different types of company – some provide financial services (consumer or business) and others provide technology or processing services. Some are regulated, others are not. There are big differences between a digital banking start-up with a banking license, and a company providing cryptocurrency trading infrastructure. That makes generalisations very difficult and deeper analysis is required on each sub-sector to understand key trends. In this report we offer a high level overview but our research can also provide a much greater level of detail.

We are optimistic that the UK Fintech sector will thrive as entrepreneurs and investors find new opportunities to pursue, and some of the companies formed in recent years mature into major industry players. Our goal is to continue to follow and understand the trends and developments as they emerge in the coming years.

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About the Research

At Clarus Investments we have been researching innovation in financial services for over 10 years. More recently we began monitoring the development of Fintech start-ups in the UK and have created a unique sector model which includes all fintech startups since 2009 which have received at least one round of funding. The research covers:

- Financing
- Valuation
- Investor returns
- Survival rates
- Exits
- Financial performance
- Employment
- Founder shareholdings
- Investor types and trends e.g. angel, corporate etc.

The research sample of over 1,000 companies can be segmented by type, sector and sub-sector. By "type" we mean whether the company provides a financial service or whether it provides a technology or processing service to another institution, an important distinction.

The analysis can help investors, entrepreneurs, corporates, regulators, government, advisers and others with identifying trends, benchmarking performance, and understanding critical success factors.

In the following pages, we have included an overview of some of the output from the research. Further in-depth analysis on any of the topics listed above can be arranged on request. Nearly 100 case studies of individual start-ups are also available.

Contents

Clarus Investments specialises in research and advisory projects in developed and developing markets. Our focus is on financial services, and in particular the topics of strategy, corporate development, innovation, growth and entrepreneurship.

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Fintech Sector Overview

This analysis of the Fintech sector covers all companies founded since 2009 which have received at least one round of funding. We estimate the number of companies that meet these criteria to be approximately 1,100.

The companies in our sample received £11bn of equity investment from 2009 to the end of 2020 and have a current valuation of around £86bn. There has been a noticeable increase in valuations since the start of the COVID pandemic.

Survival rates are relatively high with 60% of the companies at least 3 years old active and a further 18% active but not having raised any funds in the past 3 years. Successful exits are, however, relatively rare. They account for just 2% of the sample so far, although there has been a pickup in exits during 2021.

The returns on paper for investors have been very high – for a cohort including all companies founded in 2015 (and allowing for failures) the Internal Rate of Return (IRR) for first round investors is approximately 75-80%. This cohort includes Revolut which has recently been valued at £24bn, and investor returns (as expected) are very concentrated in a few winners.

While valuations and returns have been high, achieving profitability remains a struggle, even for the older companies – less than 5% of the companies in the sample are reporting profits and around 80% increased their losses in the last financial year.

The Banking sector has received the most investment, followed by Payments and Lending. However, the Banking sector has the lowest level of revenues relative to investment received of all the Fintech sectors, and incurred the highest level of losses relative to revenues in 2020.

UK Fintech Sector

(Companies Founded 2009 to 2020)

£11bn	Total equity raised*
£86bn	Total valuation**
£5.0bn	2020 revenues
-£2.2bn	2020 losses after tax
57,000	2020 employment

* 2009-2020. ** Estimated as of 31st August 2021 accounting for latest funding rounds.

Equity Raised

A total of £11.4bn was raised in the period 2009 to 2020 by companies founded between 2009 and 2020.

Pre Series A funding peaked in 2018 at £265m (see chart opposite). This indicates that the rate of new innovation has slowed in the past few years and there is more focus on investment into the companies identified as potential long-term winners.

This is confirmed by the fact that the annual number of companies founded in 2019 and 2020 is less than 50% of the level in the years 2015 to 2018.

The focus on large, later stage rounds has accelerated into 2021 with cases such as:

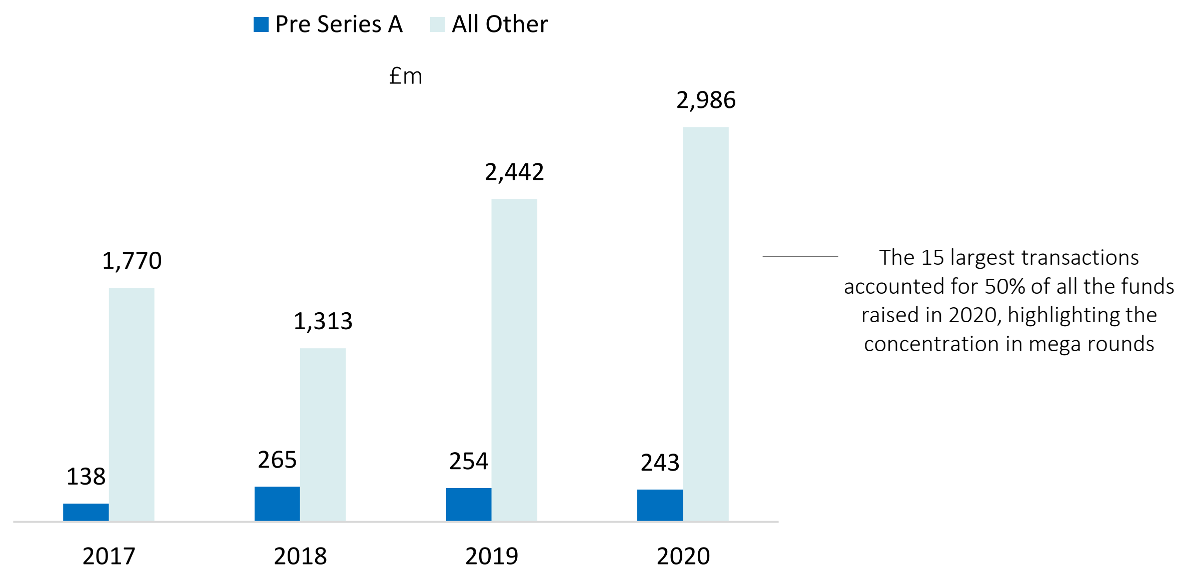
- Revolut (£580m)
- Bought by Many (£250m)
- Quantexa (£110m)

Investment in Financial Services businesses represents around 75% of the total investment from 2009 to 2020, compared to just 25% of investment going into Technology or Processing businesses.

Equity Raised by Stage

Companies founded between 2009 and 2020

"The relatively flat level of Pre Series A investment compared to the rapidly growing investment at later stages suggests a slowing rate of new innovation and investor focus on existing companies."



Notes:
Pre Series A includes Equity Crowdfunding which sometimes includes later stage rounds.
Estimates may differ from other sources due to a narrower definition of fintech and parent company domicile in UK.

Source: Crunchbase, Press Reports, Clarus Investments analysis

Status of Companies

Fintech start-ups are demonstrating reasonably good staying power. For the companies at least 3 years old, 60% are continuing and have received funding in the last 3 years (see chart opposite).

A further 18% are continuing but have had no funding in the last 3 years and the vast majority of these companies are making limited progress.

Only 15% of the companies which are at least 3 years old have closed or been through administration including for example Loot, Squirrel and Growth Street.

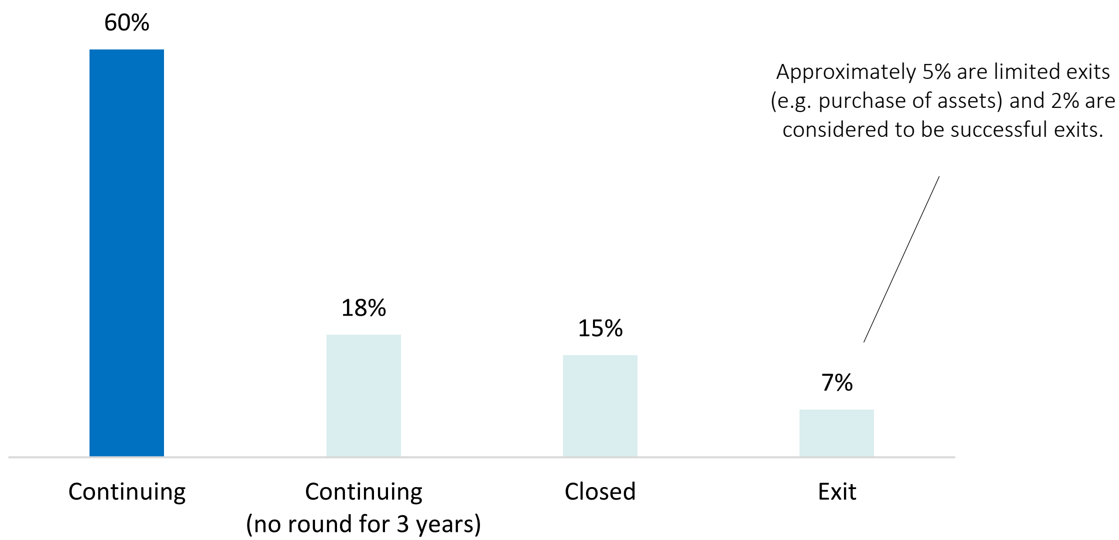
There have been relatively few exits so far. Most of these are just purchases of assets with limited or no returns for investors though there have been a few notable exits in 2021 to date including:

- TransferWise (IPO at £8,800m)
- PensionBee (IPO at £409m)
- LendInvest (IPO at £255m)
- Nutmeg (sale to JPMorgan for £700m)

Status of Companies

Companies founded between 2009 and 2017

"Survival rates are relatively high so far and although few profitable exits had been achieved by end 2020, there have been some notable cases in 2021 to date e.g. TransferWise, Nutmeg and PensionBee."



Notes:
Status as of December 2020. No round for 3 years means 2018, 2019 or 2020.

Source: Crunchbase, Press Reports, Clarus Investments analysis

Valuation and Investor Returns

Although exits have so far been limited for companies founded since 2009, the returns on paper for investors are high.

To assess this, we looked at a cohort of all the companies founded in 2015 and calculated the IRR for first round investors as of June 30th 2021. The range of returns are shown in the chart opposite.

The IRR for this cohort as a whole (assuming an investment of an equal amount in each company) was 75-80%. The cohort includes Revolut which has a particularly high valuation – excluding Revolut, the IRR for this group would have been 40-45%.

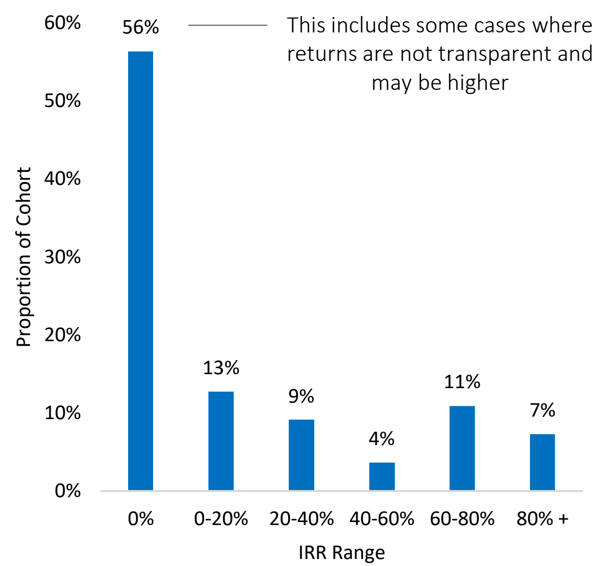
Some of the recent funding rounds in H1 2021 have been at particularly high valuations, including Revolut which was valued at £24bn – see table opposite. WorldRemit and Bought by Many also had big uplifts in valuation

However, there are less well publicised cases in 2021 where the uplift in valuation has been low or, as in the case of Atom Bank, there has been a down round.

Investor Returns and Recent Funding Rounds

"Investor returns on paper are relatively high and some recent funding rounds show a dramatic increase in valuation."

IRRs for Companies Founded in 2015



Examples of Funding Rounds in 2021

	Value at Latest Round	Change in Pre-Money Value	IRR for 1st Round Investors
	£m	x	%
Bought by Many	1,449	13.5	99%
WorldRemit	3,623	7.3	81%
Revolut	23,913	6.1	223%
Monese	148	1.1	73%
Divido	51	1.1	31%
Atom Bank	299	0.5	3%

Notes:
Some estimates have been made for the 2021 funding rounds based on media reports and assumed exchange rates.

Source: Companies House, Clarus Investments analysis

Financial Performance

Total revenues in 2020 for the whole sample of companies founded between 2009 and 2020 are estimated to have been £5.0bn. Losses after tax in 2020 are estimated to have been £2.2bn.

Less than 5% of firms are profitable and the vast majority (80%) increased their losses in their latest reported accounts.

Some of the companies reporting profits in 2020 were OakNorth, TransferWise, iwoca and LendInvest. Others, such as WorldRemit and Funding Circle have been reporting losses continuously for at least 9 years.

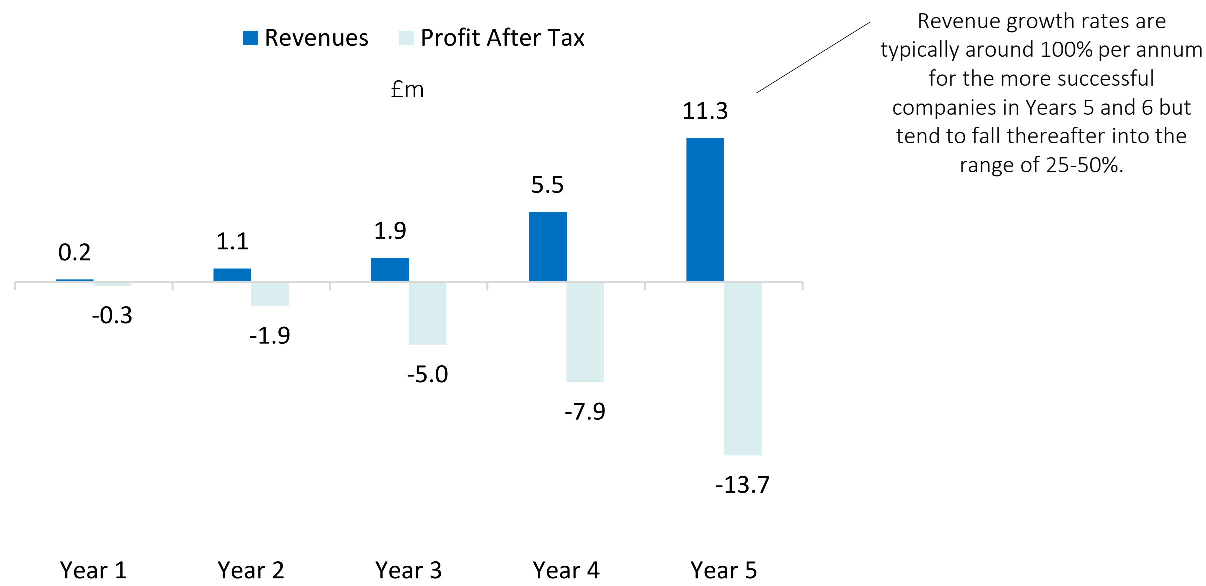
The chart opposite shows the average profile of revenues and profit after tax in the first 5 years of operation. Revenue growth rates are around 100% per annum in years 5 to 6 and then start to decline to 25-50% per annum.

Profitability should not expected in the early years but business plans typically forecast at least breaking-even by Year 5. Clearly this is far from the reality and losses in relation to revenues are still very high in Year 5.

Average Revenues and Profit After Tax in Years 1 to 5

Companies reporting for at least 5 years

"Cumulative losses from 2009 to 2020 for the whole Fintech start-up sector are estimated to have been £7.9bn."



Source: Companies House, Clarus Investments analysis

Sub-Sector Comparisons

The Fintech sector comprises many different types of company. There are some common themes evident across sub-sectors but they also have many different characteristics.

The Banking sector accounts the largest share of Fintech equity investment over the period 2009 to 2020, totalling £3.7bn of investment (see chart opposite). This includes companies with banking licenses as well as those offering bank-like services using prepaid cards.

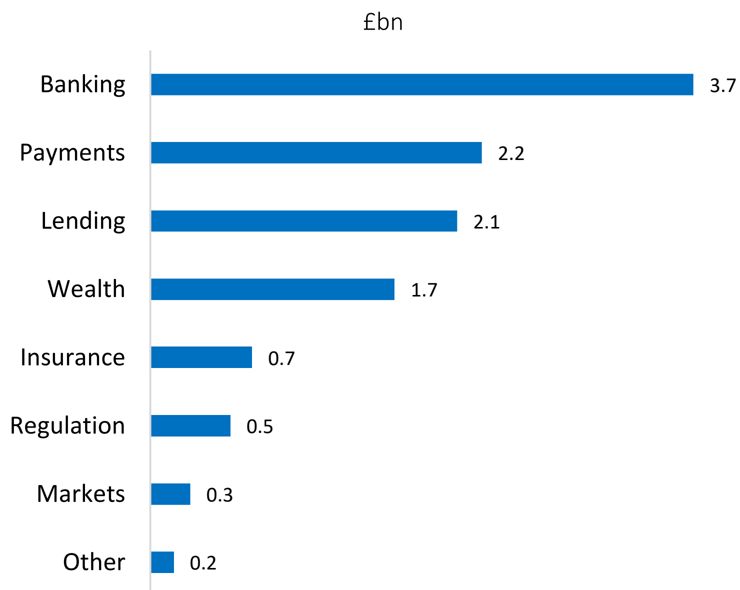
Payments (£2.2bn) and Lending (£2.1bn) are the next most important sectors in terms of investment after Banking.

Overall, Financial Services businesses represent 70% of the total investment across the Fintech sector, compared to just 30% for Technology or Processing Services businesses.

Although the Banking sector has received the most investment, the revenues being generated as of 2020 relative to the total investment made was the lowest of all the sectors, at just 23% (see table opposite).

Equity Investment by Fintech Sub-Sector 2009-2020

"The Banking sub-sector has had the most investment but is generating the lowest level of revenues relative to investment of all the sub-sectors."



2020 Revenues Relative to Total Investment in the Sub-Sector	
Banking	23%
Payments	66%
Lending	42%
Wealth	42%
Insurance	66%
Regulation	53%
Markets	81%
Other	98%

Source: Crunchbase, Press Reports, Companies House, Clarus Investments analysis

Financing Progression

The median amount raised and valuation for each of the first 4 rounds (for companies raising at least 4 rounds) is shown in the chart opposite.

The average time between rounds for the first 4 rounds is 325 days. Hence, Round 4 occurs about 3 years after Round 1.

The median raised in Round 4 is £5.1m at a valuation of £23.7m. The IRR for first round investors in Round 4 is 77%.

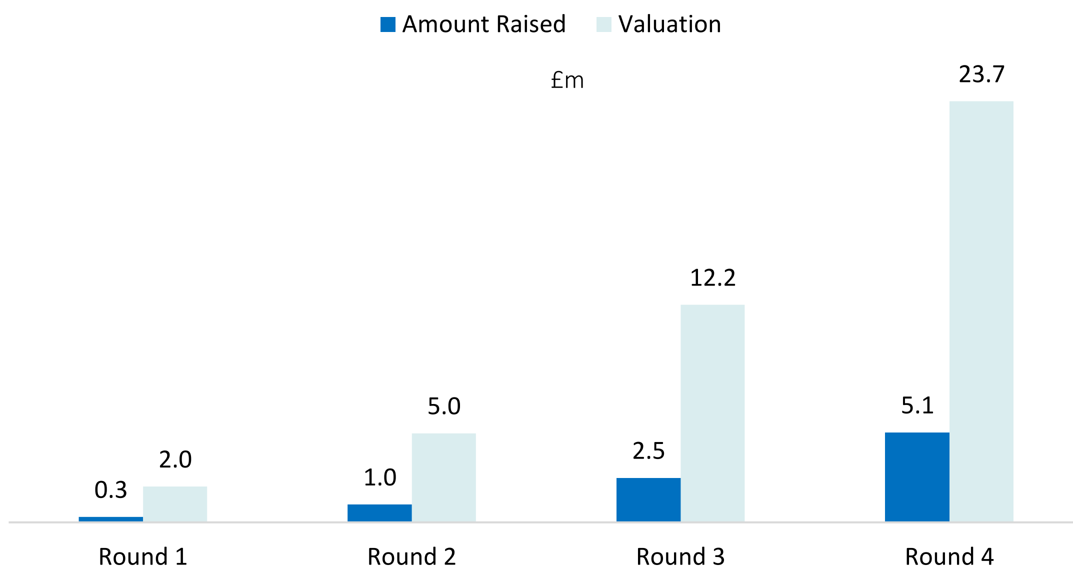
There is a wide range around these median values, for example:

- TransferWise raised £38m at a £500m valuation in its 4th round.
- TrueLayer raised £28m at a £100m in its 4th round.
- Coconut raised £2.5m at a £10m valuation in its 4th round.
- Wrisk raised £1.6m at a £5m valuation in its 4th round.

Amount Raised and Valuation at Each Round

Median values based on companies raising at least 4 rounds

"The typical progression of financing over the first 3 years shows roughly a doubling of valuation at each round."



IRR for first round investors at each round	n/a	154%	114%	77%

Source: Companies House, Clarus Investments analysis

Founder Shareholdings

Of particular interest to entrepreneurs is how to retain the maximum shareholding or value of shares as fund raising progresses over multiple rounds.

The median number of founders for companies raising at least 1 round of financing is 2. Approximately 20% of companies have a single founder.

At the first round, the group of founders on average retain 70% of the equity, with the main founder holding 46% (see chart opposite).

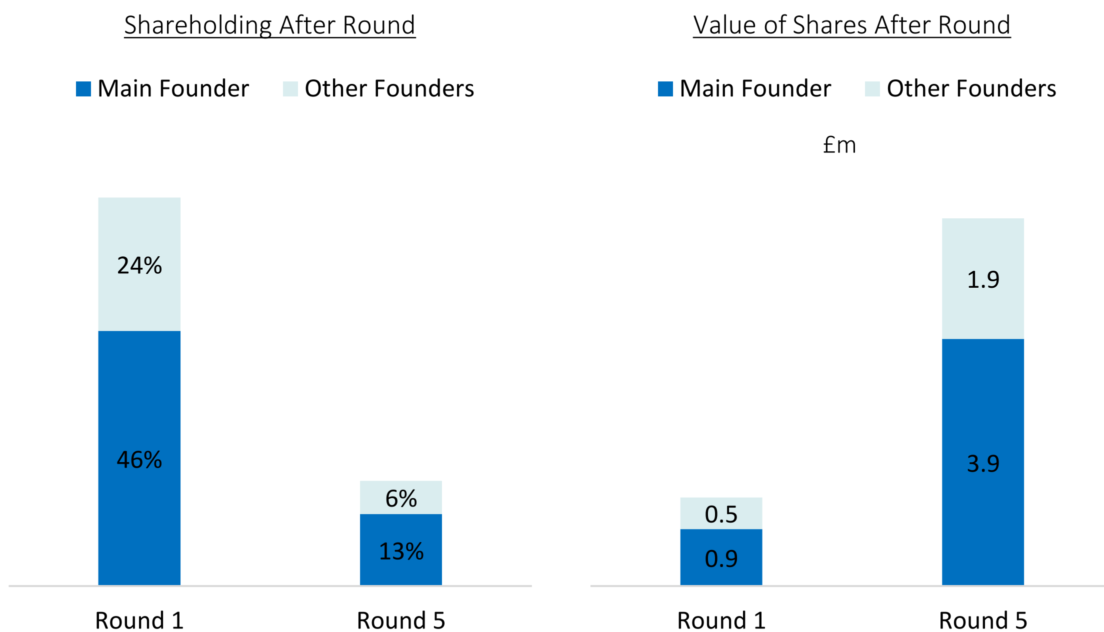
This shareholding declines over subsequent rounds of funding and by Round 5 the founders will on average hold just 19% of the shares. The value of these shares at Round 5 is on average £5.8m of which the main founder's shares are valued at £3.9m.

There is a wide variation around these averages, for many different reasons. One interesting case is PensionBee where the sole founder was able to retain 50% of the equity by Round 5 with their shares valued at around £50m. This company has since gone on to achieve an IPO in 2021.

Founder Shareholdings and Value at Rounds 1 and 5

Median values based on companies raising at least 4 rounds

"Typically, the founder shareholding declines from around 70% in Round1 to 19% in Round 5."



Source: Companies House, Clarus Investments analysis

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