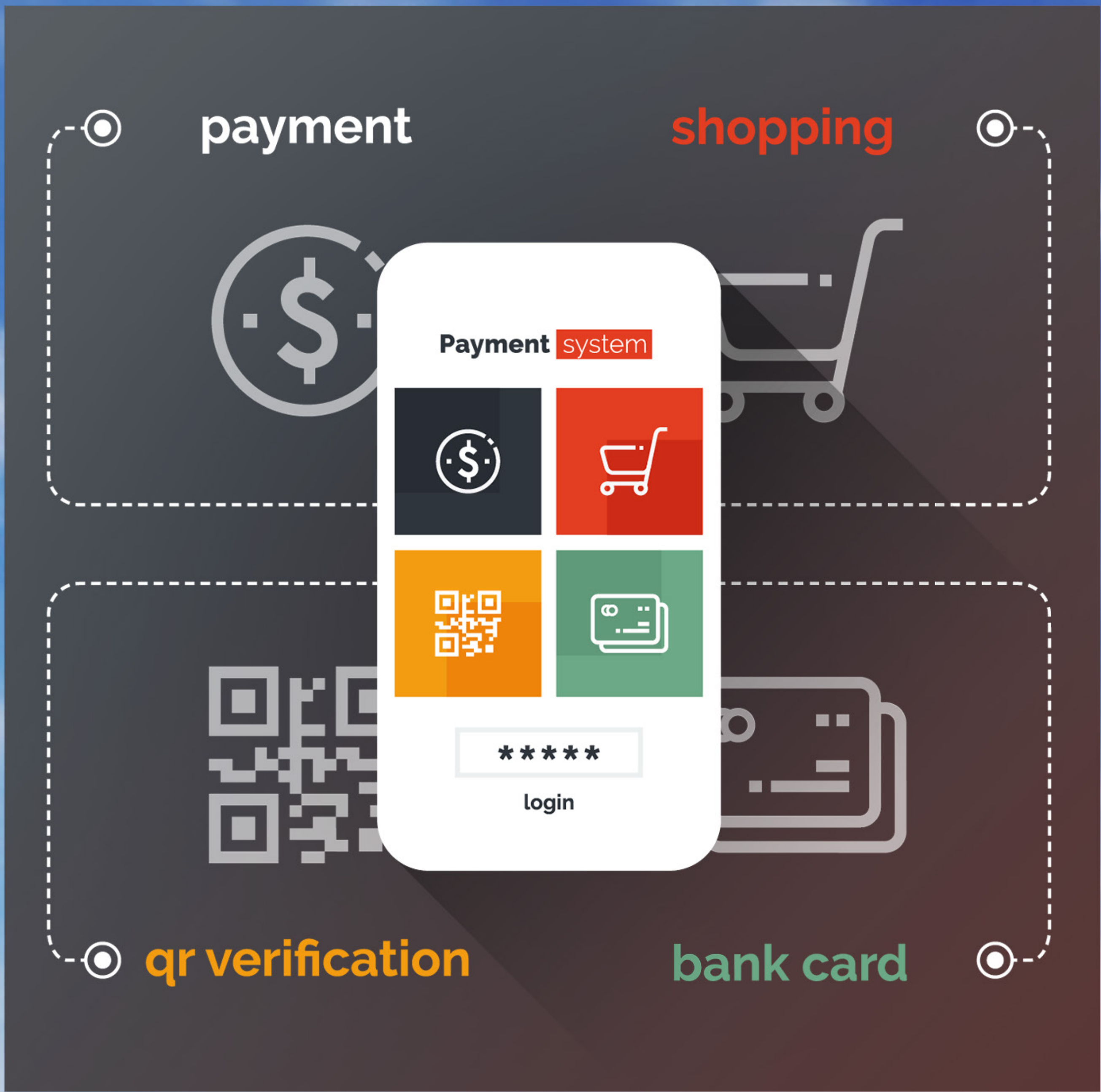
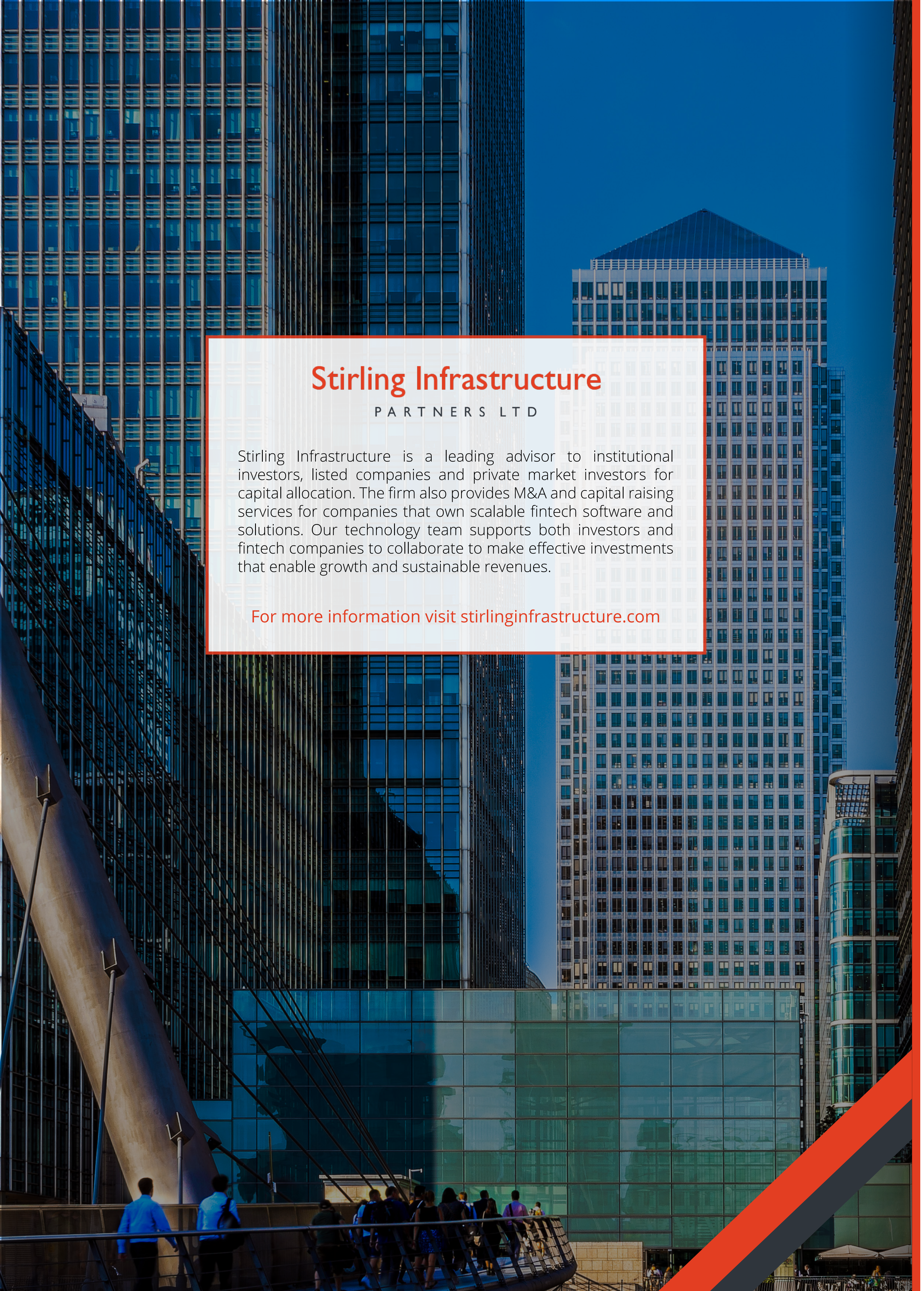
Fintech Market Insights



REPORT

M&A and Capital Raising



Stirling Infrastructure
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Stirling Infrastructure is a leading advisor to institutional investors, listed companies and private market investors for capital allocation. The firm also provides M&A and capital raising services for companies that own scalable fintech software and solutions. Our technology team supports both investors and fintech companies to collaborate to make effective investments that enable growth and sustainable revenues.

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CONTENTS

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STIRLING GROWTH CAPITAL - A DIVISION OF STIRLING INFRASTRUCTURE PARTNERS (SIP)

Stirling Growth Capital is the tech-focused division of SIP. Stirling Growth Capital has a unique mandate: to enable the growth of innovative, scalable tech companies that will make an impact across sectors and have a proven business model. Our primary focus is advising companies from series A to pre-IPO on investment origination, evaluation, capital raising and go-to-market strategy. On a selective basis we will advise companies at the seed stage. Our firm has a multidisciplinary team that provides financial expertise informed by scientific and legal professionals to evaluate emerging technologies and ventures through Stirling Growth Capital's proprietary assessment methodology.

PURPOSE

This document provides an overview of the fintech industry, across its main segments and across all life-stages of a fintech company. It further details how Stirling Growth Capital can provide advice to ensure access to capital, business scalability, winning expansion strategy, among other key elements.

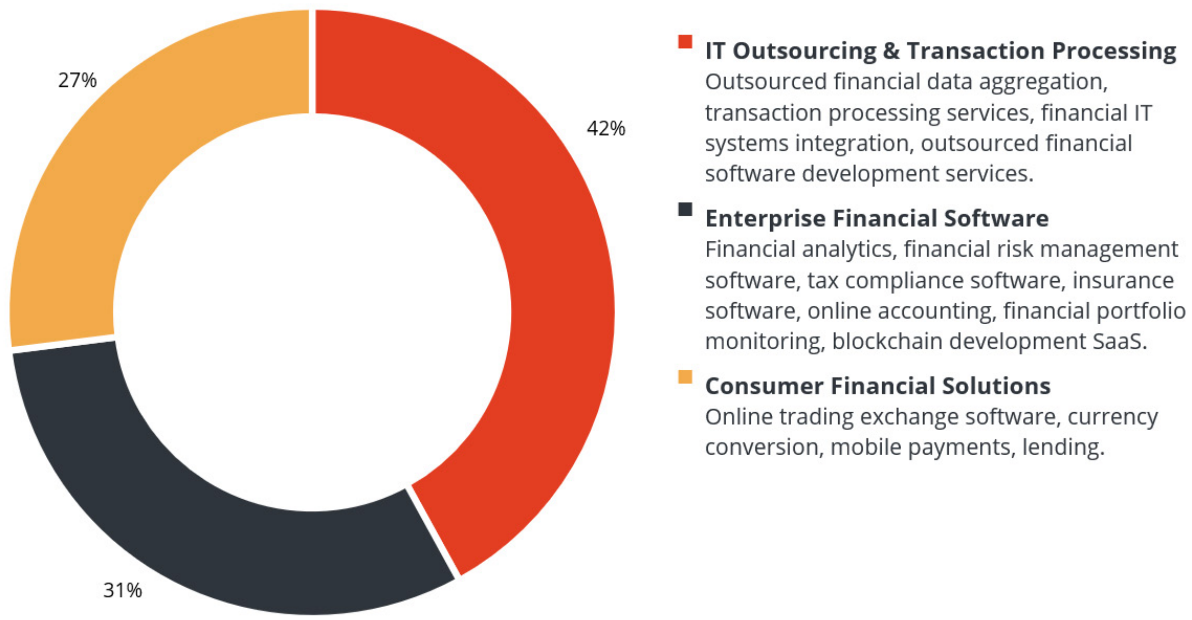
1. INDUSTRY OVERVIEW: FINTECH

Fintech companies can be defined as companies that offer a combination of technology solutions and financial services to either retail or institutional clients.[1] They have been integral in recent times in transforming the way traditional financial service firms operate and interact with consumers and also regulators.

1.1. COMPANY BREAKDOWN AND CLASSIFICATIONS

On a broad measure, the fintech industry can be broken down into three broad verticals which are: IT outsourcing and transaction processing, enterprise financial software, and consumer financial solutions. The revenue breakdown between these three fintech verticals is provided in Exhibit 1.

Exhibit 1: Revenue breakdown of three main verticals of the fintech industry



Source: Hampleton Partners

Moreover, we have observed that fintech startups fall into two mutually exclusive categories and it is imperative that investors distinguish between these two classifications when valuing a fintech startup. These are:

Fintech attackers - companies that are leveraging their superior technology and/or business models to compete with major incumbent players such as banks, brokers and insurance companies and provide a superior service for the end consumer.

Fintech collaborators - firms that sell their superior technology offering to improve the technology infrastructure at large financial institutions, allowing them to offer a superior customer experience and potentially compete more effectively with fintech attackers.

1.2. INDUSTRY BREAKDOWN AND SUBSECTOR TRENDS

Globally, the fintech industry can be broken down into various industry verticals as seen in Exhibit 2. Startups across different verticals will experience a different set of industry drivers and growth opportunities that shape their future performance.

Exhibit 2: Industry breakdown of fintech sectors, subsectors, and companies

Fintech Sector	Subsectors	Companies
Payments and Remittance	Payments Infrastructure	Adyen, Stripe, Square
	Alternate Payment Method Providers	PayPal, PayTM, AfterPay
	Remittance Services	Transferwise, HyperWallet
InsurTech	Commercial/Personal Insurance Providers	Zego, QuanTemplate, Risk
	Comparators	SelectQuote, Comparethemarket.com
Banking	NeoBanks (Checking Accounts & Lending Products	Revolut, Monzo, Starling Bank
	Banking Infrastructure	Plaid, Ripple. Broadridge Financial Solutions
Asset and Wealth Management	NeoBrokers and Robo-Advisory Service Providers	TD Ameritrade, Charles Schwab
	Institutional Investor Service Providers	SecondMeasure, Addepar
Others	PropTech, RegTech	PurpleBricks

The following sections will take a closer look into a few subsectors which Stirling Growth Capital sees as particularly promising and where we believe we can leverage our understanding to deliver the most value for our clients.

Payments

Broadly, the payments industry includes all companies that are involved in processing electronic payment transactions. The transactions can vary across C2C transactions (transactions made between two individuals), C2B transactions (transactions made from a consumer to a merchant in exchange for goods and services), B2C transactions (transactions made from institutions to individuals) and B2B transactions (transactions made between two institutions).

Globally, payment transaction revenues accruing to established and startup payment companies has averaged 6% CAGR from 2013-2018 and is expected to maintain the same pace of revenue growth over the next 5 years.[2] Within the payments industry as a whole, we see two distinct pockets of opportunity.

Payments-as-a-Service

The first opportunity within the payments industry has been the emergence of the Payments-as-a-Service (PaaS). Companies operating within this space are focused on simplifying payments integration for merchants and providing a range of value-added payments services to optimise the way merchants are able to accept electronic payments.

Uptake for PaaS companies is likely to be driven by a range of factors. The first of which is the globalisation of commerce. Cross-border transaction volumes are expected to grow at a CAGR of 9% over the next 3 years with cross-border e-commerce sales projected to grow at a CAGR of 15% till 2023.[3] This has posed a challenge for merchants in being able to provide locally tailored payment solutions to meet the needs of a global shopper base that uses a fragmented set of preferred payment

Advising companies on financing digitally-connected financial systems

methods. The inability to provide a range of payment options to match the preferred payment option for all consumers may cause a merchant to lose out to competitors providing great opportunities for innovative PaaS players to gain share. Moreover, the inability of incumbent players (traditionally banks and/or pureplay acquirers) to offer cheap, simple and fully integrated payments solutions acts as a further growth driver for PaaS upstarts.[4]

Cross-border B2C payments

Another opportunity we have identified in the Payments industry is within cross-border B2C payments driven by the increasing need for global mass pay-outs, with the rise of outsourcing, and the inefficient yet costly offerings by traditional banks.

Traditional wire transfers, utilising the SWIFT messaging network, are characterised by their unreliable speeds and non-transparent costs. This could pose considerable implications on business profit margins. Should a direct relationship not exist between the sender's bank and receiver's bank, depending on the banking infrastructure, this could see to a transfer time of between 2-5 business days across 2-7 intermediary banks, all of whom would be taking an unspecified cut of the transferred amount. Therefore, there is a significant gap in the market for global payment providers to facilitate efficient, low-cost international B2C transfers with different providers tackling different pain-points of the old traditional system.

Some payment providers allow transfers to be cleared within the hour and others offer a fraction of the cost of a traditional international bank transfer. Their popularity is shown by new entrants experiencing over 50% growth in annual revenues. Aggregated services including tax reporting and integrated financial tools as well as real-time tracking are some additional benefits of the end-to-end experience provided by B2C catered payment providers.

Where these disruptors largely differ is in regard to their network and connectivity. As many rely on increasing transfer speed and lowering costs through utilising local bank transfers and payments to supersede an international wire transfer, they have been required to build their own global banking infrastructure network. A more extensive reach allows the payment provider to cater to a wider currency pool and thus more easily see to a greater adoption amongst businesses. However, currently, these B2C disruptors are mainly targeting the SMB market with larger enterprises still largely untouched. Whether this be due to the preferred status quo of large businesses seeing value in the reliability of wire transfers, or in relation to payment providers' scope in facilitating greater flows of currencies, this may be an opportunity for future innovation and disruption in the B2C market moving forward.

Digital Banking and Alternative Lending

In terms of consumer facing fintech banking solutions, the market can be divided into two subsegments. The first being the challenger banking industry and the second being alternative lenders comprising of peer-to-peer lending service providers and nonbank lenders.

Challenger Banking Industry

Challenger banks can be defined as banks that have a completely online presence and no physical branches. Furthermore, these players are characterised by much leaner organisational structures and newer and more efficient IT infrastructure than large incumbent retail banks.

Globally, the challenger banking market was worth $18.6 billion in 2018 and is projected to grow revenues at a CAGR of 45.8% and quadruple their active client base over the next 5 years. Regionally, the European neo-banking market is the most developed with 47% of global neo-banking startups operating in the region.[5] While initially driven by a less saturated banking sector within UK and Europe, European regulators through their open banking legislation have broken the monopoly that traditional banks have over customer data, paving the way for challenger banks.

Business Model for Challenger Banks

There are a few distinctions to be made between the revenue models employed by a challenger bank and those employed by a regular 'high-street' bank. Most notably, 'high-street' banks offer a full suite of lending and savings products to consumers and make money on the net interest margin (NIM) on these products. Neobanks, however, offer a more limited product range and most-commonly operate on a tiered subscription model offering 'premium' services such as insurance or stock trading[6] for an additional fee. Neobanks also make money from commissions earned by recommending products by third-party partners as well as interchange fees when an electronic payment is made.

With that being said, challenger banks are able to differentiate themselves in a few ways. The first is through a lower priced offering undercutting more expensive offerings by traditional banks. More importantly, challenger banks rely on their superior technology interface and user experience combined with faster onboarding and approval times to differentiate themselves from incumbents.

The Next Phase of Growth for Challenger Banks

We see the next growth phase for challenger banks coming from Asia. There are a number of tailwinds that lead us to believe this is the case. Firstly, the target demographic for many challenger banks observed in Europe has been with millennials and Gen Y consumers as they look to take advantage of lower rates and appreciate a superior tech interface. Given that the demographic profile of many Asian economies represents large Gen Y populations, we see this as a significant untapped opportunity. Moreover, the regulatory environment in Asia is conducive for the formation of digital banks. Open banking regulation is beginning to take hold across the region with China releasing new open API regulation in January of 2020 and India building upon its open banking regulations.[7] There has also been a spate of challenger bank licence approvals in Singapore and Hong Kong and we expect these trends to continue going forward.

Lack of Profitability for Challenger Banks

A key concern for investors when taking an equity stake in a challenger bank has been a lack of profitability where players are currently making a net loss on each customer. There are a few explanations for this effect. Firstly, given that churn rates of consumers with existing financial institutions is quite low (2-5%), challenger banks have been required to offer significant incentives to encourage consumers to switch.[8] More fundamentally however, given that the product suite for challenger banks are quite limited, they have fewer revenue levers meaning there has been a cap on total revenue per user. Furthermore, consumers have been using challenger banks as secondary bank accounts in addition to an account with a 'high-street' bank. In fact, when surveyed only 48% of British challenger bank users consider their bank account with the challenger bank to be their primary account.[9] This means that there are fewer transactions made using challenger banks' accounts further driving down revenue per customer.

Given these concerns, there has been a growing trend toward VC investors becoming more sceptical of challenger banks as an investment and a resultant impact on funding rounds. Most recently, UK-based Monzo has confirmed that its latest funding round in May 2020 has occurred at a 40% discount to the valuation they were able to receive in their previous funding round in 2019. These trends have only been accelerated by the COVID-19 crisis as deal volumes and valuations in the fintech sector as a whole have been affected.

Alternative Lenders

Alternative lending on the other hand refers to peer-to-peer lending platforms as well as non-bank lenders that put their own capital at risk. Both players are catered towards borrowers that have been underserved by traditional lending institutions. These borrowers have traditionally included individuals as well as small businesses with poorer credit ratings.

A Closer Look at P2P Lending Platforms

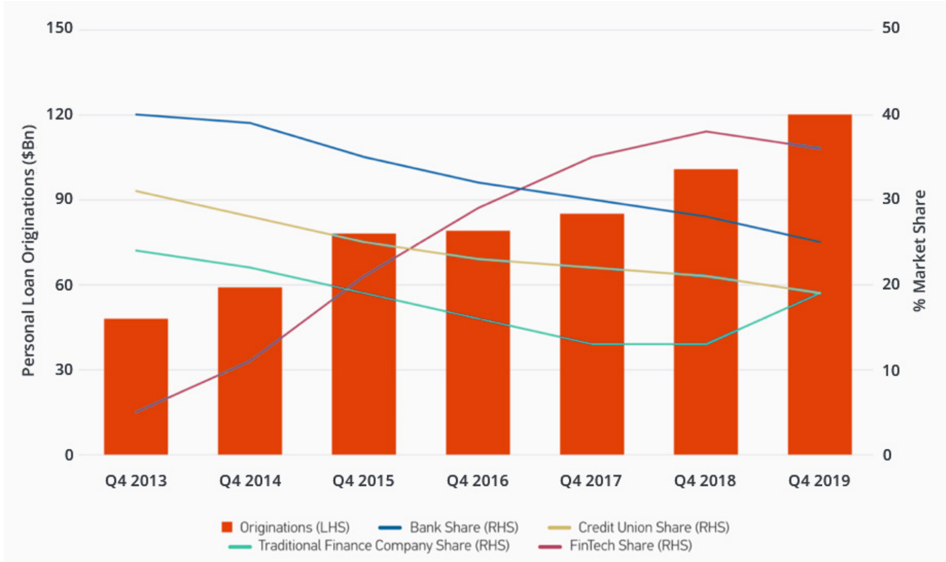
A peer-to-peer lending service is an online platform that uses technology to bring together borrowers with loan investors seeking attractive yield-generating investments. The platform themselves are involved in underwriting and distributing the loans to investors by allowing them to take pro-rata allocations of loans that meet the investors' specific criteria in terms of duration, credit risk, etc. Whilst the platforms initially underwrite the loans, the investors assume the entirety of credit risk involved. On the lending side, as volumes have ramped up and the asset class matured, most loans on an alternative lending platform are funded by institutional investors and even banks as opposed to individual savers.

Competitive Advantages for Alternative Lenders

Alternative lenders in general have benefitted from a number of trends. First, both P2P lenders in their underwriting processes and nonbank lenders have taken advantage of alternative datasets and AI processes to verify the credit quality of their buyers. Lenders have also turned to financial engineering through accepting creative sources of collateral such as the borrowers' social networks. Furthermore, the tight regulatory control over traditional banks since the global financial crisis in maintaining high credit quality across their loan book has allowed alternative lenders to take share. This can be seen in Exhibit 3 where fintech share of personal loans in the US has risen from 5% to 37% over the past 6 years.

Exhibit 3: Personal loan originations and & market shares in the US by lender type

2013-2019



Source: transunion.com

Asset and Wealth Management Services

Wealthtech refers to the use of digital solutions and technology-enabled tools within asset and wealth management. Whilst many opportunities for disruption lie within this sector, we have focused on how e-Brokers, robo-advisors and finally AI and wider digitisation are currently transforming the wider industry.

E-Brokers and the Race to Zero Commissions

Increasingly, there has been the rise of the 'young investor' with millennials entering the market and becoming a new source of demand. For these retail investors who typically invest smaller sums of capital, the importance of low-cost trading becomes even more significant. Therefore, many disruptors within the e-Broker space, i.e. notably Robinhood, began operating under a 'zero commission' business model to cater to this growing market. Being widely dubbed as the "Robinhood Effect", soon traditional brokers followed suit with 2019 seeing the likes of Charles Schwab, E-Trade, TD Ameritrade and Fidelity eliminating trade execution commissions. From just 10% of market trades in the beginning of 2019, soon retail investors grew to account for 15% of total market trades as barriers to entry lowered for casual traders. COVID-19 has further seen to cement this move towards zero commissions with the figures for retail investor trades rising to 20% in light of accelerated market movements and volatility, proving retail investors to be a significant market to tap into.[10] However, with the now saturated market offerings and commission-less trades becoming the norm even among legacy brokers, new wealthtech entrants may need to seek other entry points, covered below, that cater to these rising retail investors.

Robo-Advisors and the Disruption of Traditional Asset Managers

Robo-advisors have been gaining much market share over recent years, fundamentally changing the advisor business model. These are digital platforms that provide automated, algorithm-driven asset and wealth management services with little to no human supervision.

The low fee structures offered by robo-advisors have been the main differentiator from the traditional advisors, which has successfully attracted the younger market who make up a substantial proportion of demand for robo-advisors. Through the elimination of human input, services can be offered for an annual fee of around 0.2% to 0.5% of a client's total account balance, a fraction of typical asset managers' fees. Moreover, with significantly less minimum capital requirements to register for an account, robo-advisors are becoming widely adopted among retail investors who may not have huge sums of capital to deploy but still wish to gain some financial management expertise. Whilst most traditional offerings have a minimum investment amount of $500,000 or even $1 million, with rising fintech such as Wealthfront and Betterment offering no account minimum, they have successfully tapped into the small to medium investor market that is growing in recent years. This has seen to the steadily rising global AUM under robo-advisors at nearly $1.1 trillion in 2020 and forecast to grow at an annual rate of 25.6%,[11] not the least driven by the e-Brokers' race to zero commissions further attracting lower capital retail investors.

AI and Digitisation

Although robo-advisors are indeed on the rise due to their low fee structures, increasingly retail investors are becoming more independent with the rise of financial education and access. This has seen to a new model of managing money: one of self-reliance. Therefore, these markets demand greater digitisation to ensure all information and data is accessible via their fingertips from news to account management- a significant area that poses opportunities for wealthtech disruptors.

Even high net worth individuals, predominantly the younger generation, are increasingly favouring more personalised and digital experiences proving this area to be a hotspot for activity and disruption. Surveys conducted reveal that some 37.5% would consider allocating 11% to 50% of their wealth to big tech companies such as Google and Amazon indicating their receptiveness to wider technological innovations within asset and wealth management.[12] With the ability of such companies to offer clients ease of access and fluidity to their services that many traditional wealth managers struggle with, this indicates a gap in the market that could be fulfilled by collaboration between traditional pure tech companies and wealth management firms, or prove to be an opportunity for rising wealthtech startups.

The deployment of artificial intelligence sees great potential alongside the wider digitisation. Not only can AI provide personalised digital advice catered to individual clients, real-time data is also readily available. This allows for greater client focus and, alongside human advice, can see to the strengthening of client relationships. Therefore, rather than one of disruption and displacement, we instead see great opportunity for partnerships and collaboration between traditional managers and rising AI developers as incumbents race to adopt new technologies to ensure they remain ahead of market trends. With 93% of wealth managers saying AI will play a role in the future of their practice, this bodes well for potential exit opportunities for startups within this space.[13]

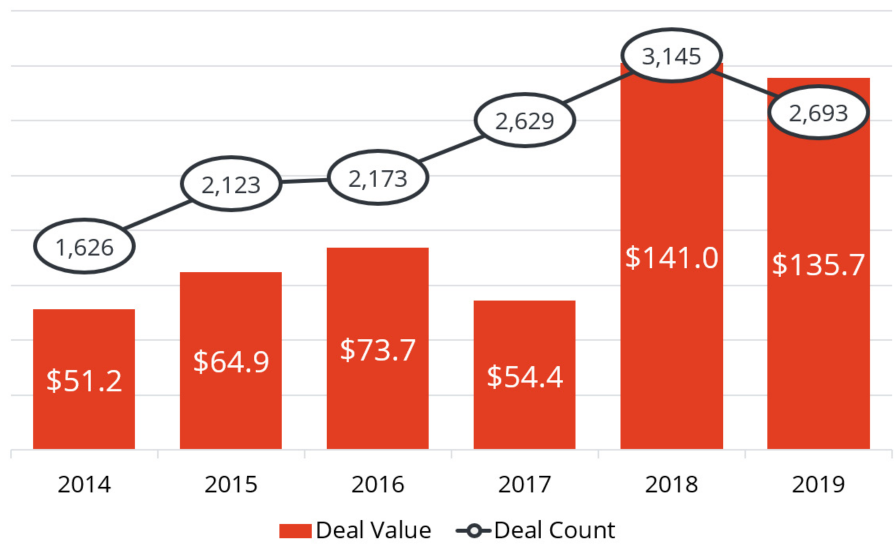
2. TRANSACTIONS & CAPITAL

2.1. GENERAL DEAL TRENDS

Broadly in terms of funding trends, the fintech sector in general has been successful in attracting private risk capital to fund the growth of pre-IPO stage fintech upstarts. This trend has been particularly prominent over the past 3 years with a sharp increase in both deal volumes and deal value (M&A, VC & PE transactions) from 2016 to 2018, with a slight moderation of deal volumes in 2019 (Exhibit 4).

Exhibit 4: Total investment activity (VC, PE and M&A) in fintech

2014 - 2019

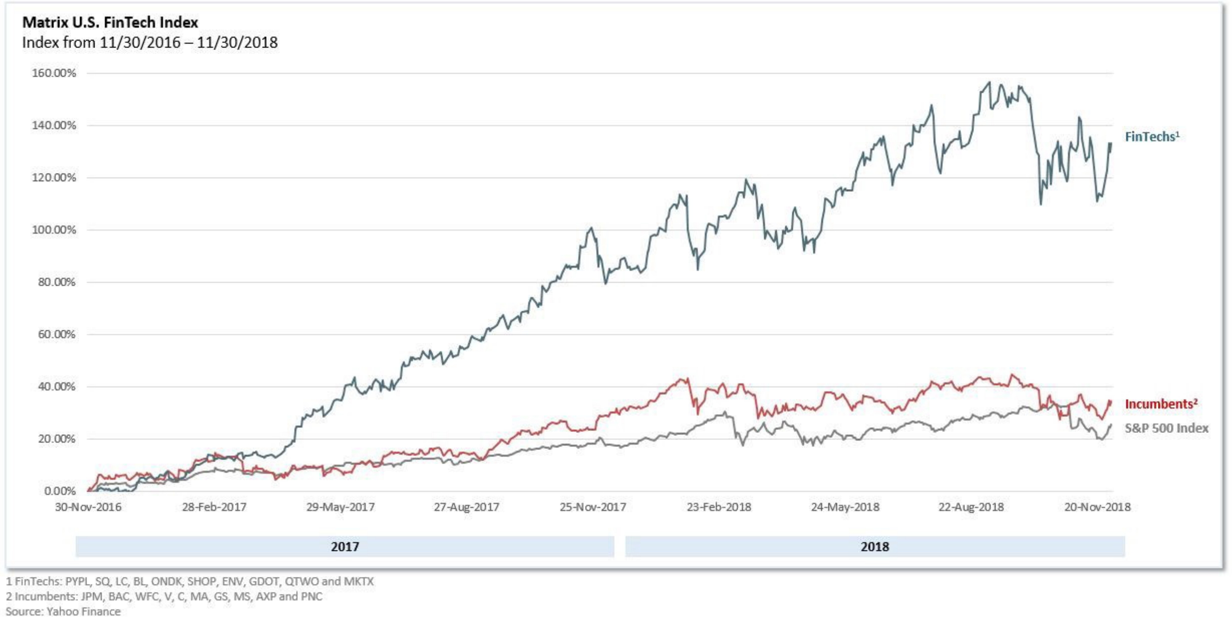


Source: KPMG

Moreover, the increase in private deal activity has seen a dramatic increase in the valuation of fintech upstarts both private and public. The 'Matrix Fintech Index' which tracks the valuation of publicly listed fintech companies has significantly outpaced S&P 500 Index (Exhibit 5). Given that public market valuations are a key driver of the prices VC funds are willing to pay for pre-IPO companies, there has been a simultaneous increase in the valuation of private fintech companies.

Exhibit 5: Matrix US Fintech Index

11/30/2016-11/30/2019

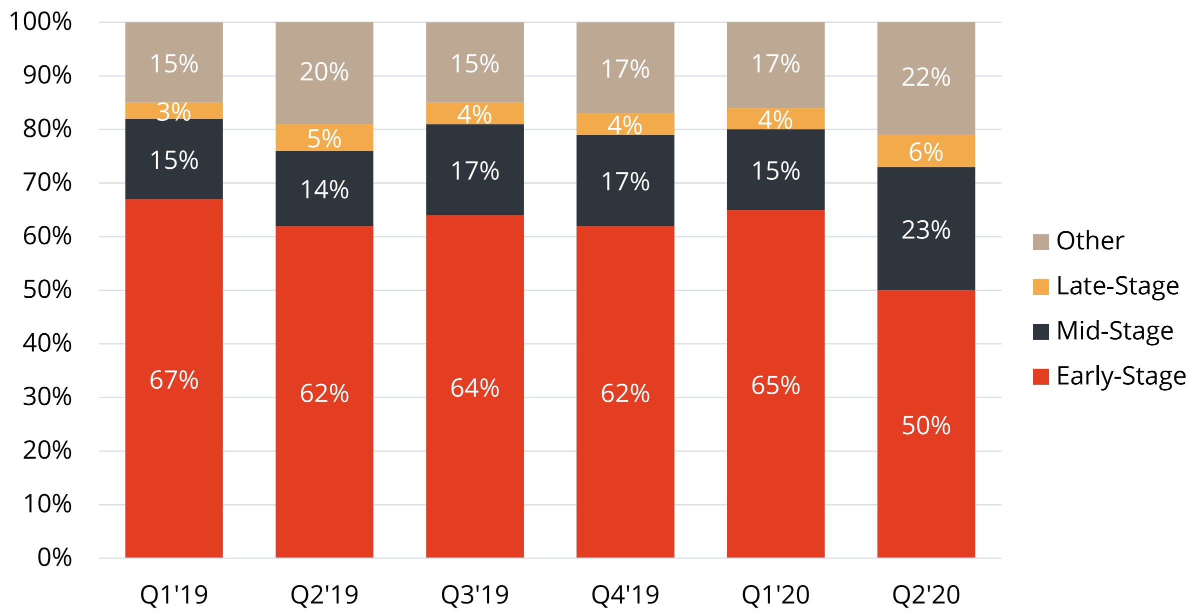


Source: Matrix Partners

However, given the high valuations throughout 2019, there was a moderation of fintech valuations especially in early stage fintech deals. This effect was further worsened with the onset of COVID-19 crisis, where there was a decline in deal activity across all funding stages with the falls being most significant with early stage fintech deals. However, coming out of the crisis, whilst public markets have performed exceedingly well, there has been a slower recovery in private market fintech funding with deal value rebounding by 17% in Q2'20 and deal counts declining.[14]

Exhibit 6: Global percentage deal share to fintech companies

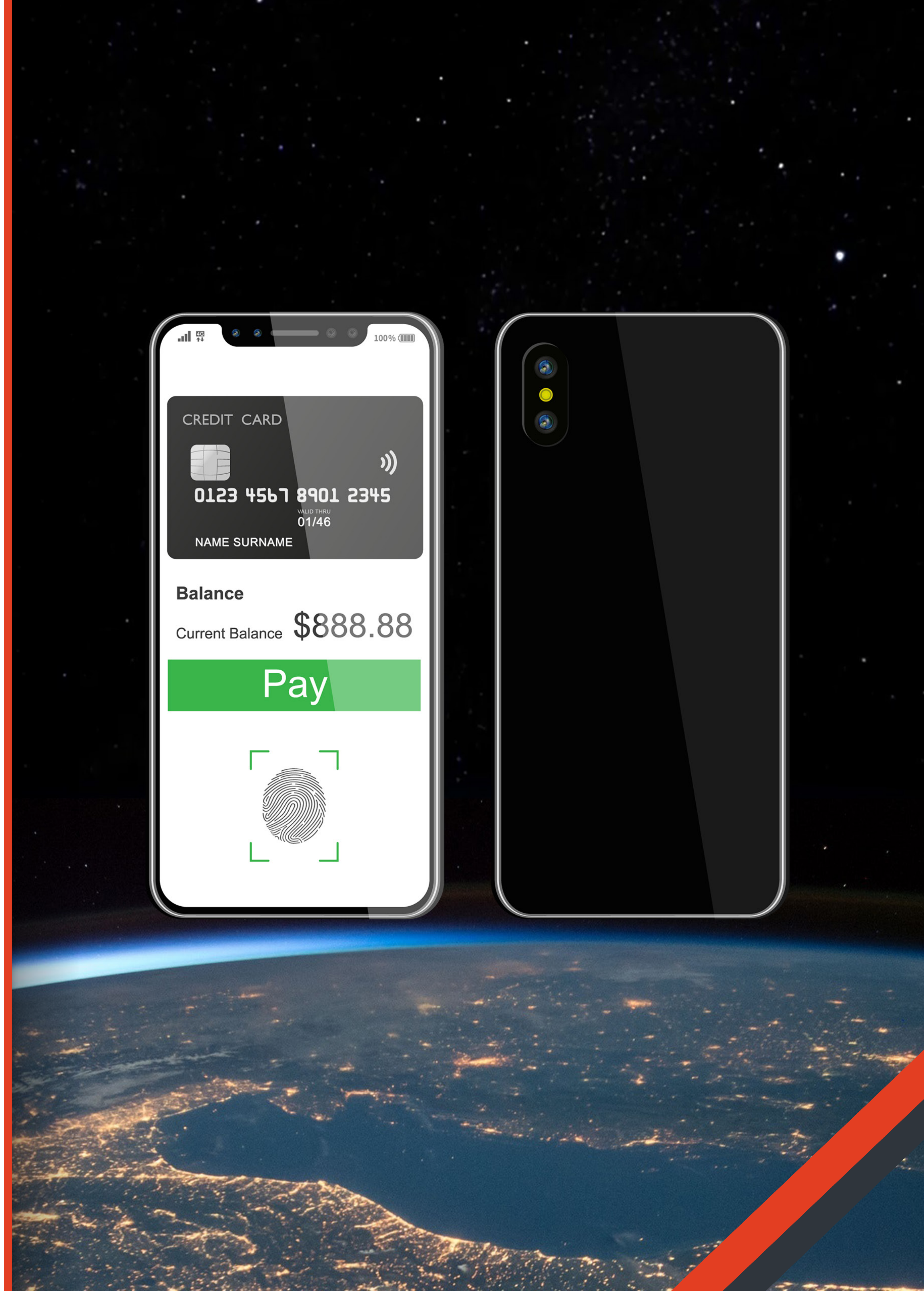
Q1 2019-Q2 2020



Source: CB Insights

Trends in M&A Investments

The 2019 M&A market for the fintech sector demonstrated a few interesting developments. First, there was an increase in both deal count with the number of M&A transactions rising to the highest level since 2015 and an increase in transaction multiples with the average company being bought at a multiple of 17.3x trailing thirty-month EBITDA.[15]



More interesting, however, was that M&A transaction values through 2019 were driven by an increase in the number of mega-deals within the space, particularly within the payments vertical with large deals such as Fidelity's acquisition of Worldpay ($44 billion), Fiserv's Acquisition of First Data ($22 billion) and Global Payments merger with Total System Services ($21 billion).

We expect these trends to continue given that fintech upstarts across many industry verticals are beginning to mature and pose a serious threat to incumbents. M&A activity within fintech will be driven by incumbents either acquiring upstarts or combining with other incumbents to strengthen their position.

Performance of the Fintech IPO Market

The poor performance of the IPO market for technology startups in 2019, combined with the increased willingness of both public investors (such as Fidelity, T.Rowe Price and Tiger Global Management) and late stage VC funds in participating in late-stage mega rounds in funding has meant that there were fewer fintech IPOs in 2019. In fact, the number of fintech megarounds where deal values exceeded $100m+ has grown by 40% y-on-y in the US.[16] Moreover, since Q4'18 there have been 41 new tech unicorns recorded as tech firms have been choosing to remain private.

However, the second half of 2020 has seen a 'very fertile' IPO market where IPO deal value year-to-date stands at $70 billion outpacing the $62.5 billion for all of 2019. Moreover, with September and October traditionally the busiest months for IPO listing activity, the total IPO deal value is expected to be the second-largest since 2000. Furthermore, the average one-day gain for US IPOs this year stands at 25.4% outpacing the 15.2% in 2019 and 11.9% in 2018.[17] These two facts have meant that issuers have been eager to fast-track their IPO timeline. Notable fintech IPOs for this year include the blockbuster IPO of Snowflake in September.[18] We see the creation of fintech unicorns over 2018 and 2019 as pent-up IPO demand which we expect to unwind over the next few months.

2.2. OPTIMAL VALUATION

For investors looking to appropriately value fintech startups, it is important to understand that the best valuation practices will vary across the various industry subsegments within fintech. For instance, the business model breakdown and metrics used to value an insurtech startup will wildly diverge from the analysis done for a payments service provider. However, at Stirling Growth Capital we see a few best practices that investors should adopt independent of the industry vertical.

Companies should adopt prime financial management structures to secure balance cash flow and financial health – these include measures to control customer acquisition costs, as well as active monitoring of cash burn rates. Companies should further ensure legal protection for their businesses – legal, compliance and robust intellectual property protection must be in place to protect the value of the business model and products.

In terms of product development, companies should ensure that their product offering possesses a unique selling point that differentiates its product from those existing in the market – this is especially so given that there has been an influx of new fintech upstarts across a majority of the industry verticals resulting in a fragmentation of the market. In order to maintain a competitive advantage, companies must be able to not only explain the scientific innovation behind their product, but also continuously innovate and update their product to ensure that the products fulfil an existing 'demand-gap' not satisfied by incumbents.

At the same time, market players or companies seeking to enter a market should actively monitor their total addressable market to ensure that the specific market they are entering into has sufficient scope for growth in the long run, and demand is capable of sustaining new entrants into the market.

Lastly, when participating in capital raises, companies must be able to identify and source the right capital for their business – from public capital markets to strategic acquirers to financial sponsors, only the right form of investment can optimise a company's growth and help it achieve its objectives.

3. STIRLING GROWTH CAPITAL'S VALUE PROPOSITION

3.1. CAPITAL RAISING FOR BUSINESSES AND COMPANIES

Our unique selling proposition involves our in-house research using the proprietary specialist metrics and diagnostic test which the Stirling Growth Capital team has developed.

Our first step in the capital raising process is to assess and advise companies on their readiness for capital raising across all funding rounds. This includes ensuring that companies have the right systems, cash management processes, intellectual property, and legal structures in place before entering funding rounds. We do this via a diagnostic test consisting of a 90-point check, designed by a competent science team which has a proficient understanding of the fintech sector which companies may operate in.

The diagnostic test includes a detailed analysis on the target's financial position and business model growth prospects. We have developed 55 financial, business and valuation metrics that assess companies on diverse aspects, including profitability, liquidity, scalability, customer attraction and retention, among others. Our metrics are classified into 4 revenue models (Subscription/Licensing, Transactional, Contract-based and Financial Services) covering the whole spectrum of business models across the value chain of tech industries such as fintech, enterprise software, energy tech, transport tech, water tech and prop tech.

We then prepare companies for capital raising by positioning the opportunities to the right type of capital in a manner that is best suited to the companies. In this process, we advise on the investor appetite for the specific type of fintech solution in the market, and align the most appropriate source of capital to the company's objectives – be it strategic or passive capital.

Lastly, we support companies' interests through the capital raising process by negotiating terms with counterparties to achieve the optimal valuation and price for the companies seeking a capital raise, assessed through our proprietary diagnostic test.

3.2. ADVISING INVESTORS SEEKING TO INVEST IN THE FINTECH INDUSTRY

Using our proprietary diagnostic tests, we are able to employ our in-house metrics to advise investors on the valuation of target companies. This includes multiple valuations through peer analysis, as well as a risk diagnosis of both external market risks and internal risks of companies (e.g. management and operational risks). We further conduct due diligence of prospective target companies to assess whether the target company is at fair market value, scalable, and bankable, and identify potential weaknesses and downside risks to its return on investment.

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FOR FURTHER INFORMATION

This report is a primer that presents our technology transaction team's expertise in the fintech software market. Our strengths include raising capital from institutional investors, listed companies and private market investors. The firm provides access to a global network for our clients to scale their business interests and also provides comprehensive M&A transaction services.

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This document has been developed by our analysts and does not constitute investment advice. It is prepared for information purposes only and does not constitute an investment recommendation.

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