Why are most fintech’s staying private, and will this change anytime soon?

The ongoing cascade of Covid-originating disruption has in some ways been a blessing in disguise for the UK’s fintech sector. The forced abandonment of traditional ways of doing business around the world has underlined the growing relevance of the sector in general, and several UK startups have risen to prominence thanks to the fleet-footed and self-assured way they have grasped the opportunities that disruption always brings.

Temps de lecture : minute

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10 December 2020

A prominent example would be Aviva-backed startup Shepper, who provide a gig economy solution for companies looking to source people to undertake snap inspections of physical assets. Shepper has seen digital footfall spiral during the pandemic as more people look to monetise portions of their free time. Tasks advertised on the platform attract varying rates of pay, and could be as quick and simple as photographing a local bus stop for the council who want to know the extent of vandalism or graffiti, or popping into a local supermarket to get pictures of certain branded products to ensure they are being displayed as per the contract signed with the proprietor.

Clearly, the upside growth potential of the fintech sector is enormous, but for the UK investor keen to gain exposure to this, a frustratingly limited range of publicly traded stocks has been available. This article considers the related questions of why so many fintechs prefer staying private rather than floating through an analysis of Funding Circle, one of the very select group of UK fintechs who are both publicly listed and reasonably well established in their market. Private equity deals in the fintech sector hit a peak of 14 deals (totalling $5.1B in value) in 2018, and have only slowed moderately since then. Will more fintechs follow where Funding Circle has led?

Funding Circle Holdings Plc: a cautionary tale?

Founded in 2010, UK-based peer-to-peer lending platform Funding Circle is already something of a veteran of the UK's fintech scene. Just over two years out from its 2018 floatation, and ten years out from its initial inception, Funding Circle has more than proved its durability and the ongoing viability of its approach to online financial services.

More than that, Funding Circle holds the rare distinction among its competitors of having genuinely achieved a level of wide-spread recognition and brand awareness far in excess of what most fintech startups realistically expect to achieve. Glossy TV ads extoll the virtue of Funding Circle's fast and low-cost business loans, and the company's simple but memorable purple logo is recognisable to a surprisingly large spread of the public. More important than this, however, is the fact that Funding Circle has a track record of generally delivering healthy (if not spectacular) revenue growth, both prior to and following its IPO in 2018.

And yet, despite its well-known and closely curated brand, loyal retail customer base, and mostly positive revenue record, none of these can obscure the fact that the share price has performed very badly since the listing, and many analysts remain lukewarm on Funding Circles' medium-term prospects, with the consensus view still being 'Hold' rather than 'Buy'.

Peer-to-peer lending during the pandemic

According to Bloomberg, Funding Circle is currently tracked by just four analysts, one each from Morgan Stanley, Goldman Sachs, Barclays, and Numis. Currently, all bar Numis have a ‘Hold’ recommendation, with only Numis advocating ‘Buy’, along with a slightly optimistic target price of 427. This price would take the stock back to the highs it achieved on initial floatation, and held until around March 2019, when a consistent slide in the valuation set in.

This downward trend stabilised around June/July 2019, and the price has remained fairly constant since. Overlaying the FASOFT index on the chart above, comprised of financial and software companies broadly comparable to Funding Circle, emphasises the extent of Funding Circles underperformance relative to its peers.

However, there are good reasons to believe Funding Circle’s valuation may have reached its support level, and thus the stock may have a great deal of upside potential looking ahead. Interestingly, part of the story behind this is the combination of Funding Circle's advanced peer-to-peer lending technology and the economic realities of the pandemic for the SMEs who Funding Circle specialises in lending to.

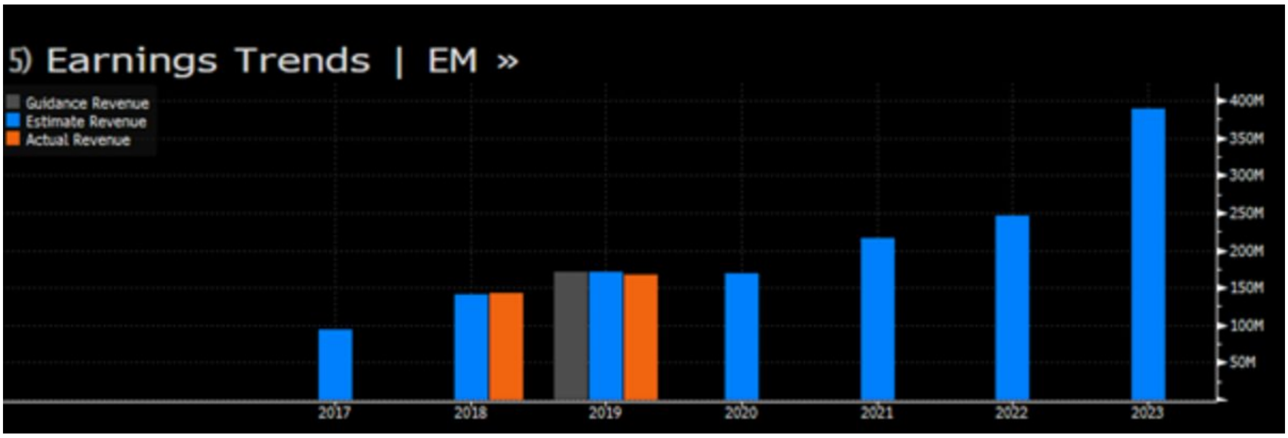
To briefly journey back to 2019, and the beginning of the slide in Funding Circles' share price, the platform was indeed struggling at the time; Funding Circle announced a profit warning on the 2nd of July based on a change in its 2019 outlook due to the unfavourable juxtaposition of a highly uncertain macroeconomic environment and slackening demand. As a result, the business was led to tighten its lending criteria to defend investor returns on the platform. All of this was enough to downgrade full year revenue guidance from an implied growth of 40%, to just ~20%, a dramatic halving of the growth rate.

A little over a year on, and such gloomy assessments were replaced by optimism stemming from an unexpected source; the massive fiscal interventions in both the UK and US, Funding Circles' two key markets at present, meant demand for small business loans from Covid-distressed companies soared.

As part of their most recent earnings release, Samir Desai co-founder and CEO stated that, "We started Funding Circle after the financial crisis to help small businesses access funding, and we are proud that since becoming accredited to SME government guarantee programmes in the UK and US, we have approved more than £2B of loans, and are the 5th largest CBILS lender with circa 20% market share of loans approved."

CBILS, or the Coronavirus Business Interruption Lending Scheme, was and remains a highly significant part of the fiscal-firepower the UK government brought to bear on the Covid-stricken economy, and the extent of Funding Circles' involvement in the scheme is an astonishing testament to both the long-term durability of the peer-to-peer lending model in general, and to Funding Circle's growth potential in particular.

The marked uptick in analysts' expectations for Funding Circle can be seen clearest in the dramatic estimated future revenue flows the platform is expected to generate over the next few years, with the consensus being that revenue could double in the next three years.

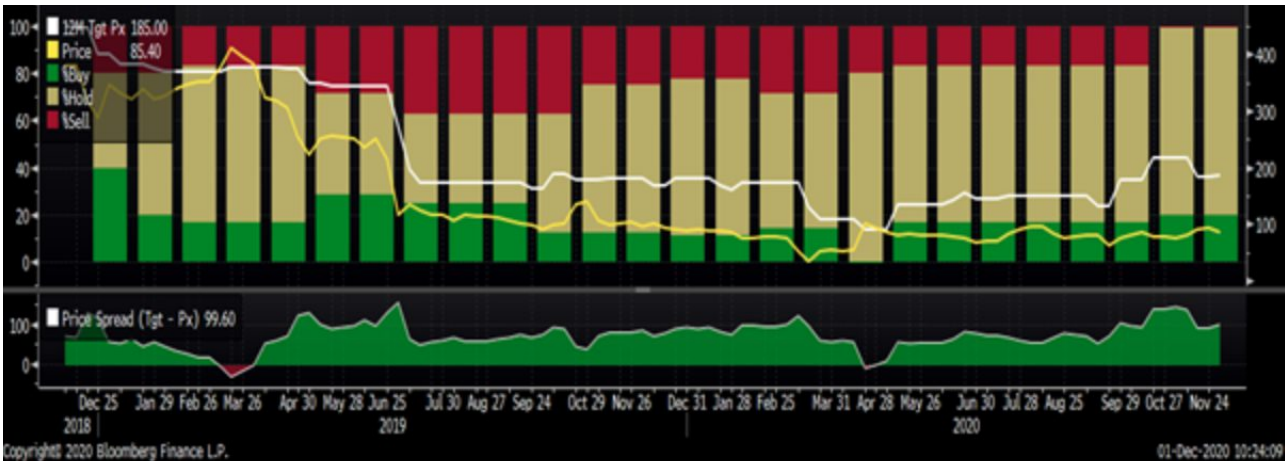


Whether these estimates turn out to be accurate or not, the fact is Funding Circle is now back on a growth trajectory, and CBILS and the life-support system much of the real economy remains on is a big part of that story.

Indeed Numis now reports that Funding Circle actually beat their expectations in the four months ending October 31st: "The strong growth profile, the structural change in small to medium enterprise finance, towards online and the prospect of further government support for small to medium enterprises brings forward and enhances group profitability," the U.K. brokerage claims. Numis now expects the company to report an earnings per share loss for 2020 of 29.2 pence, compared with previous expectations of a 36.2 pence loss. For 2021, the brokerage sees a loss of just 2.0 pence, compared with prior views of a 3.1 pence loss, and shares are up 1.20 pence, or 1.4%, at 90.20 pence, on the back of this news.

Should I stay or should I go (public)?

With hindsight, the doldrums Funding Circle found itself in in mid-2019 seems to have been little more than passing turbulence. Looking at the chart below, the steady decline away from the red ‘Sell’ recommendations towards a plateauing consensus of ‘Hold’ with a lone ‘Buy’ recommendation tells an undramatic but important story in itself. A similarly positive conclusion can be drawn from the 12-month target price also consistently tracking above the share price.



Funding Circles’ journey over the last year has highlighted a lot of the issues other fintechs will have to grapple with in taking the decision to either go public or stay private.

Whilst the capital gained by going public, to say nothing of the publicity and brand awareness benefits, will undoubtedly tempt many tech entrepreneurs, the burden of extensive and regular financial reporting, and the volatility that this can bring to the company’s valuation, are equally likely to give pause for thought. Essentially, going public in such a dynamic sector as fintech may well look like an opportunity best grasped at a later stage of development than many startups are currently at.

Arrayed against this are the equally hard to weigh costs and benefits of staying private, either with founders retaining the majority equity, or with private equity investment.

As of today, Funding Circle can certainly be considered a UK fintech success story, and a company who has ultimately benefited from taking the leap and listing, albeit after spending eight years establishing itself as a viable player in the market. However, with US private equity groups aggressively hunting for fresh opportunities in a low yield landscape, and many fintech startups in need of new capital injections quickly, it is doubtful whether there will be many new listings by fintechs in the near future, with the pace of private equity acquisitions likely to accelerate. However, it will certainly be an option for the next generation of fintech companies who grow to be comparable to Funding Circle in size and visibility.

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