2023 **US Banking Technology** Market Report – Startup Edition

S&P Global Market Intelligence

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Incumbent banks should avoid the inclination to breathe a sigh of relief as fintech stocks fizzle. Some fintechs already have profitable business models and could therefore still pose a threat. Incumbents must also adapt to the ways that fintechs have changed expectations for banking services, like the removal of overdraft fees for customers and the provision of open banking APIs for software developers. Additionally, the health of the fintech industry is a concern for banks that partner with fintechs through banking-as-a-service agreements as well as incumbents that have invested in the space.

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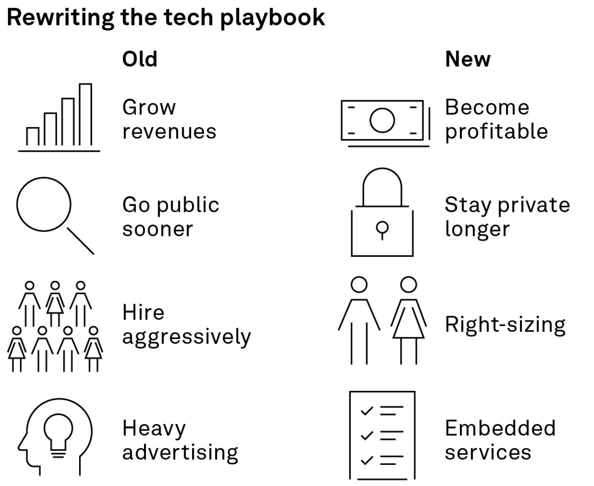
Once the would-be industry disruptors, banking tech startups are now largely on the defensive. They are keenly focused on reaching profitability to win back investors that soured on growth stocks once the Federal Reserve started hiking interest rates. This is a major reversal in mindset for the tech industry, which has historically prioritized growth over profits.



Some banking tech startups have already achieved profitability and can likely weather the storm. But the rest will need to trim expenses, which many have done by reducing headcount. We also expect startups to slash their advertising budgets if they have not already.

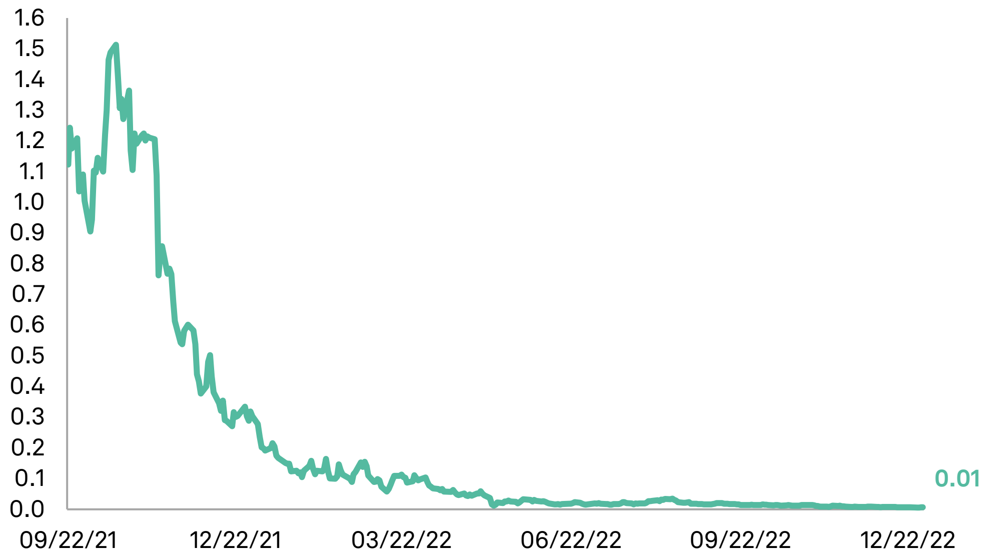
On the revenue side, neobanks have proven their ability to rapidly gather deposits. But now, if they want to become profitable, we think they must better monetize them. Increased lending is the best avenue, in our opinion, though startups must be careful to avoid too much credit risk. Some digital lenders have reduced originations for that very reason, becoming more selective about the loans they make. Enterprise software companies have different choices to make, but they are not a major focus of this report.

We think much can be learned from the past to predict the future. As in the dot-com crash in 2000, we expect a wave of industry consolidation in 2023 and 2024, with some companies throwing in the towel and others selling their operations at a significant discount to their peak valuations. We expect heightened M&A volume in 2023, though the deal sizes will likely be small, and a fair portion of those transactions will probably be asset deals rather than whole-company acquisitions as buyers have more power to dictate deal terms. To the extent startups seek to retain their independence, past cycle busts show it is exceedingly difficult for unprofitable companies to stay afloat.

How long the rout will last is anyone's guess. But the Nasdaq peaked in March 2000 of the dot-com boom and did not bottom out until October 2002, at which point it had lost 78% of its value. Assuming a similar situation today, the Nasdaq peaked in November 2021, meaning tech stocks might not recover until June 2024. An index we constructed of recently public U.S. banking tech companies peaked about a month earlier than the Nasdaq, and it has lost 99% of its value since then.

Index of recently public US banking tech companies

Comprises companies that did an IPO or SPAC merger since the start of 2020



Data compiled Jan. 4, 2023.
The market-cap weighted index comprises U.S.-based banking technology companies that either completed an initial public offering or special purpose acquisition company merger since Jan. 1, 2020, and whose shares were listed on either the Nasdaq or the NYSE.
The index components are: Affirm Holdings Inc. (AFRM), Alkami Technology Inc. (ALKT), Blend Labs Inc. (BLND), BM Technologies Inc. (BMTX), Cuentas Inc. (CUEN), Dave Inc. (DAVE), FinWise Bancorp (FINW), Katapult Holdings Inc. (KPLT), loanDepot (LDI), MoneyLion Inc. (ML), nCino Inc. (NCNO), Open Lending Corp. (LPRO), OppFi Inc. (OPFI), Rocket Cos. Inc. (RKT), SoFi Technologies Inc. (SOFI) and Upstart Holdings Inc. (UPST).
FinWise was added Nov. 19, 2021, and accounted for only 0.02% of the total index's value on that date. All other stocks traded the entire period shown.
Source: S&P Global Market Intelligence.

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This edition of the U.S. Banking Technology Report provides insights into the health of fintech startups that specialize in traditional banking activities and predictions on how they will strategically navigate the current environment. While there are many types of companies within the "banking technology" category, this report focuses primarily on neobanks and digital lenders. In addition to being some of the most well-funded and highly valued startups of the past decade, they also pose the most direct competition to incumbent banks. Broadly speaking, to consider inclusion, a banking technology company must be tech-forward and investing heavily in cutting-edge digital products and services, either for clients or their own back-end operations.

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-The macroeconomic outlook and Federal Reserve's policy responses are critical to the health of the fintech space and particularly banking tech. Higher interest rates have caused public market investors to avoid growth stocks and recessionary fears have made lenders and loan buyers more cautious.

-Tech startups across the board are doing layoffs to reduce expenses, and we think they will target advertising for expense reduction as well. This could be an opportunity for incumbent institutions to pick up talent, either by hiring laid off employees or by doing "acqui-hires" of struggling startups.

-The extent to which consumer-facing banking tech companies can monetize their deposits, be it through loans or fee-based services, will be critical to increasing revenue and, ultimately, profitability. We think personal loans are the most logical and lucrative option, but origination growth will be tougher to achieve in 2023.

-While lending seems the best bet for neobanks and digital lenders to reach profitability, they need to be wary of credit risk. In the dot-com era, several digital banks survived the market meltdown in tech stocks, but the loans they made became non-performing years later and those banks ultimately failed.

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Rising interest rates caused public market investors to ditch growth stocks, which has pummeled fintech company valuations. This is bad news for management and existing investors. But it is a buyer's market for new investors and potential acquirers.

The Federal Reserve's rate hikes are challenging for private companies as well. Those companies will need to demonstrate a profitable business model if they want to go public. Additionally, higher interest rates have increased the hurdle rate for venture capital investors. We think VCs are likely demanding stricter terms and being more cautious about the startups they back.

The window for fintech initial public offerings has closed and should remain that way until public market investors show a renewed appetite for growth stocks. That rotation, we think, is dependent on a more optimistic economic outlook, an end to the Federal Reserve's monetary tightening and the ability of tech companies to demonstrate profitable business models. Special purpose acquisition company deals were another popular method of going public, particularly in 2021, but we think those vehicles are unlikely to return even in more favorable economic conditions. Going forward, we think public market investors will opt for firmly underwritten public offerings as an indicator of a more heavily vetted investment opportunity.

In our view, fintech companies are wise to put their IPO and SPAC deal plans on hold, as their shares would likely get crushed in the open market. Filing for an IPO or agreeing to a SPAC deal and then not completing it is also a costly exercise.

Valuations of select US banking tech companies fell sharply in 2022

	Market cap ($M)		
Name (ticker)	**12/30/22**	**12/31/21**	**Change (%)**
Upstart Holdings Inc. (UPST)	1,082.4	12,400.2	-91.3
Affirm Holdings Inc. (AFRM)	2,805.8	28,257.9	-90.1
MoneyLion Inc. (ML)	157.2	920.5	-82.9
Cuentas Inc. (CUEN)	3.5	19.9	-82.4
Blend Labs Inc. (BLND)	342.3	1,687.5	-79.7
Katapult Holdings Inc. (KPLT)	94.2	328.5	-71.3
Open Lending Corp. (LPRO)	852.5	2,836.8	-69.9
SoFi Technologies Inc. (SOFI)	4,277.8	12,757.4	-66.5
Dave Inc. (DAVE)	109.7	325.1	-66.3
loanDepot Inc. (LDI)	276.1	640.4	-56.9
Rocket Cos. Inc. (RKT)	852.4	1,891.9	-54.9
OppFi Inc. (OPFI)	29.7	61.1	-51.4
nCino Inc. (NCNO)	2,935.8	5,307.7	-44.7
BM Technologies Inc. (BMTX)	63.8	112.4	-43.3
FinWise Bancorp (FINW)	119.0	176.1	-32.4
Alkami Technology Inc. (ALKT)	1,334.7	1,768.2	-24.5
Total	**15,336.8**	**69,491.5**	**-77.9**

Data compiled Jan. 4, 2023.
Limited to U.S.-based banking technology companies that either completed an initial public offering or special purpose acquisition company merger since Jan. 1, 2020, and whose shares were listed on either the Nasdaq or the NYSE.
Source: S&P Global Market Intelligence.

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Most US banking tech companies that went public in past 3 years have underperformed

Red indicates stock trading below $1 per share

	As of Dec. 30, 2022		
Name (ticker)	Price change vs. S&P 500 (pps)	Price change since going public (%)	Closing price ($)
FinWise Bancorp (FINW)	6.6	-11.8	9.26
nCino Inc. (NCNO)	-36.4	-14.7	26.44
Upstart Holdings Inc. (UPST)	-37.8	-33.9	13.22
Alkami Technology Inc. (ALKT)	-44.5	-51.4	14.59
SoFi Technologies Inc. (SOFI)	-45.2	-53.9	4.61
BM Technologies Inc. (BMTX)	-51.7	-47.9	5.21
Open Lending Corp. (LPRO)	-52.9	-32.5	6.75
OppFi Inc. (OPFI)	-68.3	-79.5	2.05
Rocket Cos. Inc. (RKT)	-76.5	-61.1	7.00
Dave Inc. (DAVE)	-78.8	-97.1	0.29
Blend Labs Inc. (BLND)	-80.1	-92.0	1.44
MoneyLion Inc. (ML)	-81.1	-93.8	0.62
Affirm Holdings Inc. (AFRM)	-81.3	-80.3	9.67
Katapult Holdings Inc. (KPLT)	-81.4	-90.4	0.96
loanDepot Inc. (LDI)	-86.3	-88.2	1.65
Cuentas Inc. (CUEN)	-97.5	-95.8	0.18

Data compiled Jan. 4, 2023.
Limited to U.S.-based banking technology companies that either completed an initial public offering or special purpose acquisition company merger since Jan. 1, 2020, and whose shares were listed on either the Nasdaq or the NYSE.
Source: S&P Global Market Intelligence.

Nearly all the U.S. banking tech companies that went public on the major exchanges since the start of 2020 have underperformed relative to the S&P 500, based on the broader market's performance over the length of time the company has been public.

FinWise Bancorp was the lone exception; though its stock was down relative to its IPO price of $10.50 per share, set in November 2021, it has performed better than the broader market. While FinWise has a heavy focus on technology, it also has a bank charter, which as we explain later in this report could help explain its outlier status; SoFi is the only other company in the group that owns a bank. FinWise has also been consistently profitable in each of the years since going public, whereas SoFi has not.

Enterprise software companies nCino and Alkami have fared a bit better than others, but their lack of profitability is likely weighing on shares. That said, online mortgage lender Rocket Cos. Inc. has been consistently profitable and has still been hit hard. Investors might understandably be nervous about a shrinking mortgage market, but we think they are painting the entire fintech universe with the same brush.

A few of the recently public companies are now at risk of being delisted. Neobanks Dave and MoneyLion have both received noncompliance notices from their exchanges, respectively, on July 27 and on Nov. 23. Dave's board approved a 1-for-32 reverse stock split in response, which other tech companies have tried as well. But judging by how those stocks have fared, we think a better option would be to find a well-capitalized acquirer, if one is available.

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Cash levels are now an important consideration for the entire fintech universe. Based on third-quarter 2022 earnings, most of the companies in our banking tech sample had at least a year's worth of cash they could burn through, assuming the same level of losses as in the most recent period.

But Blend Labs, Dave and Cuentas could need to raise more capital soon, assuming they cannot reverse their net losses. They probably want to avoid a dilutive equity raise and might be wary of raising debt now that interest rates are higher. There might be other options, such as a private equity infusion, which could come from management and/or founders, the company's previous VC backers or elsewhere. This assumes they can find investors willing to take the risk, however.

Some banking tech companies could be cash-strapped within a few quarters

	As of Q3'22		
Company (ticker)	Cash and cash equivalents ($M)	Net loss ($M)	Burn rate (months)
Dave Inc. (DAVE)	38.6	47.5	2
Blend Labs Inc. (BLND)	114.4	132.7	3
Cuentas Inc. (CUEN)	2.1	2.3	3
nCino Inc. (NCNO)	106.5	22.6	14
Alkami Technology Inc. (ALKT)	96.6	20.0	14
BM Technologies Inc. (BMTX)	26.4	4.9	16
MoneyLion Inc. (ML)	126.4	21.0	18
Affirm Holdings Inc. (AFRM)	1,530.1	251.3	18
loanDepot Inc. (LDI)	1,143.9	137.5	25
Katapult Holdings Inc. (KPLT)	77.2	8.2	28
Upstart Holdings Inc. (UPST)	684.0	56.2	36
SoFi Technologies Inc. (SOFI)	935.2	74.2	38
OppFi Inc. (OPFI)	14.0	0.7	64

Data compiled Jan. 4, 2023.
Burn rate calculated by dividing quarterly net loss by three to get a monthly loss estimate, then dividing cash and cash equivalents by the monthly loss. The rate assumes that the company will have the same level of losses in the future as it did in the third quarter of 2022.
Limited to U.S.-based banking technology companies that either completed an initial public offering or special purpose acquisition company merger since Jan. 1, 2020, and whose shares were listed on either the Nasdaq or the NYSE.
Source: S&P Global Market Intelligence.

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One way of becoming profitable is to cut expenses, and a big source of expenses for tech companies is headcount. The sector saw a slew of layoffs in 2022, from companies big and small, and fintech was no exception. Digital mortgage lender Better.com, corporate card provider Brex and neobank Chime are just a few of the companies in the digital banking space that have reportedly reduced their ranks.

Tech startups often hire aggressively to scale their businesses, and the ocean of venture capital that flowed to the space in recent years supported those efforts. Pandemic-era conditions were highly favorable to fintechs, as stocks soared and customers did more transactions online, which likely provided further justification to grow headcount.

These layoffs could offer an opportunity to incumbent institutions, as there is now a pool of fintech alums that incumbents can draw upon to guide them in digital transformation. Additionally, incumbents should have more negotiating power and can cast a wider geographic hiring net now that remote work is more commonplace. Incumbents might also consider so-called acqui-hires, where the target company is acquired at a small price and the most prized asset is the personnel. This assumes, however, that incumbents are not also in cost-saving mode amid the more challenging economic landscape.

Another big expense item for tech companies is advertising, which we think is another likely target for cuts. Based on U.S. banking tech companies that went public since the start of 2020, this shift might already be happening. Rocket Cos. Inc., for instance, cut marketing and advertising expenses by roughly one-third year over year in the third quarter of 2022. But not all have followed this path. Affirm more than doubled its sales and marketing expenses over the same period.

Neobanks typically use the same model pioneered by digital banks in the 1990s, saving on the cost of operating branches by having customers bank online and use existing ATM networks. But, like those early digital banks, neobanks also tend to spend large sums on advertising and offer high-yield accounts to acquire customers.

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On the revenue side, an obvious way for neobanks and digital lenders to boost revenue is to increase lending. Some neobanks have focused heavily on interest-free services, with the expectation of making the bulk of their revenue from interchange fees. But that strategy, in our view, is too focused on customer acquisition, or convincing more customers to open accounts on the platform, and we think those companies will change course in 2023. As they feel pressure to produce profits, we anticipate neobanks to focus more on interest-bearing loan products.

Economic uncertainty has complicated the outlook for digital lending, however. On the positive side, higher interest rates have increased customer demand for debt consolidation products. But on the negative side, recessionary fears, inflation and higher borrowing costs have made partner banks and loan buyers more cautious. Data on originations illustrates this mixed picture: Prosper grew volume 17% in the third quarter of 2022, while Upstart's originations shrank 43.5%.

Unsecured personal loans seem a natural product fit for consumer-focused neobanks, and some — like LendingClub, MoneyLion and SoFi — already offer them. Neobanks often tout their ability to help users build credit and raise their FICO scores; if their services work, it could eventually create a prime borrower base for those companies to lend to.

The "buy now, pay later" concept, which allows users to pay for e-commerce transactions in installments, falls into the personal loan category as well. BNPL created significant buzz in the fintech world when companies like Affirm burst onto the scene, but the revenue potential of services vary. Affirm offers some interest-bearing installment loans with up to 36% annual percentage yields, depending on the borrower's credit, which is on par with credit cards. But its "Pay in 4" option, which splits the purchase into four payments, has a zero-percent APY.

Home loans are another option. The good news for digital lenders is that the U.S. residential mortgage market is still a large one; the bad news is it has been shrinking dramatically amid rising interest rates. The Mortgage Bankers Association estimated total 1-to-4 family mortgage originations declined 49% to $2.245 trillion in 2022, and the industry group is forecasting another 15% decline in 2023.

The residential mortgage market contraction is a particular concern for the tech-forward mortgage lenders, like Rocket Cos. and loanDepot. Blend Labs, which provides back-end software for mortgage lenders, has also seen revenue pressure from the slowdown.

Small business loans remain a source of origination growth for Enova, which bought On Deck in October 2020. But we think it would be tough for consumer-focused neobanks to enter that market immediately, due to the different expertise it requires. Companies with relatively large cash positions might, however, be able to acquire existing platforms.

If they decide to increase lending, as we think they will, today's neobanks need to be mindful of credit risk and the capital needed to support losses. This was one of the key lessons of the dot-com crash, in our opinion. NetBank and Ebank, for instance, both managed to survive the 2000 market meltdown, but were clobbered by non-performing loans years later; those two banks failed in 2007 and 2009, respectively. Meanwhile, The Bancorp Bank and Axos Financial (formerly known as Bank of the Internet) maintained quality loan books and thrived. The two are still considered tech-forward banks to this day.

It remains to be seen whether modern fintechs will target subprime borrowers as a source of near-term profits without accurately gauging the risk involved. But there are encouraging signs they will avoid the same fate. One of the hallmarks of the latest wave of fintechs is their use of data and sophisticated models, which, if accurate, should prevent them from making bad bets on credit. While many did not experience the Great Recession firsthand, they could potentially draw on the data from those that did.

A number of savvy digital lenders have tightened their underwriting standards, decreased originations and held more loans for investment rather than selling them to institutional investors. We expect those trends to continue in 2023, which are healthy signs, in our opinion, as the companies taking those steps now should benefit in the long-run from prudent risk management.

Upstart pulled back heavily on originations

	Loan originations	
Name (ticker)	**Q3 2022 ($B)**	**QOQ change (%)**
LendingClub Corp. (LC)	3.54	-7.8
SoFi Technologies Inc. (SOFI)	3.48	8.8
Upstart Holdings Inc. (UPST)	1.85	-43.5
Enova International Inc. (ENVA)	1.20	10.4
Prosper Marketplace Inc.	1.04	17.0
Median		**8.8**

Data compiled Dec. 26, 2022.
Source: S&P Global Market Intelligence.

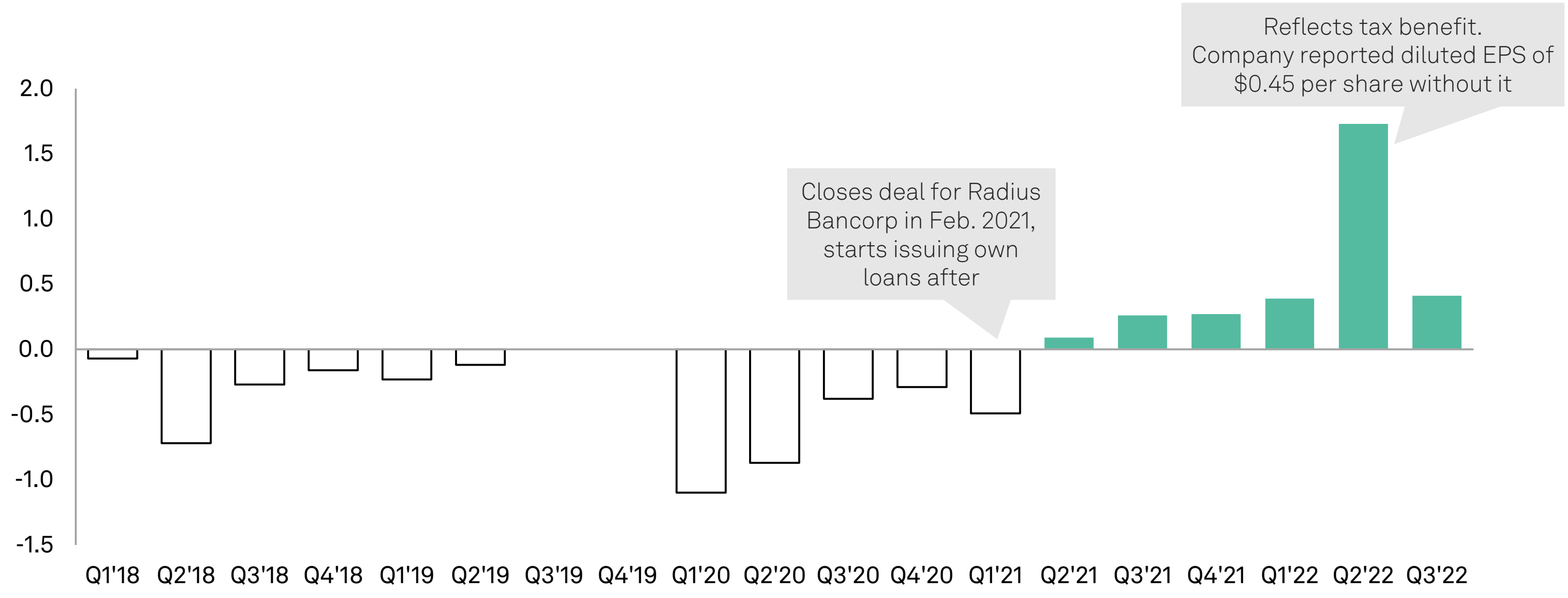
Becoming a bank offers many advantages; it provides a relatively low-cost, stable source of funding and eliminates the fees a startup would pay to its partner bank under a banking-as-a-service agreement. Therefore, we expect startups to continue pursuing bank charters in the years ahead. But those deals seem harder to close, due to increased regulatory scrutiny. Regardless of whether they obtain them, fintech companies still need to develop and execute a profitable business model.

The startups that have become banks within the past few years have had mixed results. Despite obtaining a bank charter, Varo still makes more than 90% of its revenue from noninterest income, which has not been enough to cover expenses. SoFi, which acquired Golden Pacific Bancorp, is struggling with profitability as well, but LendingClub has posted consistently profitable quarterly earnings after closing its acquisition of Radius Bancorp.

LendingClub's origination and servicing fees — which it groups together as "marketplace revenue" — soared 86% in the second quarter of 2021 to $151.7 million and it reported positive earnings per share in the following quarter. Part of that success could be attributed to LendingClub no longer having to pay fees to partner banks that issued loans on behalf of the company.

But LendingClub also grew net interest income by retaining more loans for investment. Though it is a smaller source of income than marketplace revenues, net interest income on retained loans has been increasing for the past several quarters, going from 26.8% of total revenue in the third quarter of 2021 to 39.6% in the third quarter of 2022.

LendingClub became profitable following bank acquisition, based on quarterly EPS ($)



Data compiled Nov. 18, 2022.
EPS = earnings per share.
Numbers shown are diluted EPS figures, as reported in quarterly earnings releases.
Source: S&P Global Market Intelligence.

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Fee-based income could offer another source of revenue growth to fledgling fintechs. On the surface, this might seem heretical, as many neobanks have positioned themselves competitively by removing penalties like overdraft fees and late fees. But we think fee-based financial planning services could still be an option. The neobank and robo-advisor worlds have already been converging. MoneyLion offers an automated investing service, for instance, while Betterment offers cash and checking accounts. We think mergers between these two fintech sectors would make sense strategically and we expect to see some in the years ahead. The wealth management industry benefits from scale, so we expect consolidation in the robo-advisor space to continue.

One of the key considerations for fee-based income is account sizes. Based on regulatory filings, Varo Bank's average account size, for non-retirement deposit accounts with balances of $250,000 or less, was only $59 as of Sept. 30. Wealth management services would likely be a tough sell to those customers at the moment. But Varo and others could work to increase their account sizes in the future.

Referral revenue could be another option. SoFi has affiliate partnerships with Gabi, Ladder and Lemonade to offer insurance, for example, and runs a comparison site known as Lantern where users can shop for a variety of products, including credit cards, personal loans and small business loans. Much of the content for Lantern comes from a partnership with Even Financial, which is now owned by MoneyLion, and SoFi is compensated for the business it generates. Given this relationship, we think SoFi would be interested in MoneyLion as a potential acquisition target or a carve-out of Even Financial if MoneyLion is unable to survive on its own. While SoFi likely wants to preserve cash, it could potentially structure the deal as a stock transaction. MoneyLion paid only $15 million in cash for Even Financial, with the other $345 million coming from preferred stock.

Varo has lots of accounts, but a small average account size

Non-retirement deposit accounts with balances of $250,000 or less

	As of Sept. 30, 2022		
Bank (parent ticker)	Number of accounts	QOQ change (%)	Average size ($)
Varo Bank NA	5,118,702	7.7	59
Square Financial Services Inc. (SQ)	214,730	49.5	541
SoFi Bank NA (SOFI)	521,533	23.9	7,868
LendingClub Bank NA (LC)	126,801	-11.9	22,062
U.S. commercial banks	801,008,031	6.6	8,723
U.S. savings banks	10,106,047	3.1	16,866

Data compiled Nov. 16, 2022.
QOQ = quarter-over-quarter.
Average size calculated as the dollar amount of deposits divided by the number of deposit accounts.
Source: S&P Global Market Intelligence.

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Finally, SoFi has another relatively large revenue line in its arsenal: business-to-business applications. In addition to its consumer products, it offers software solutions, like APIs and core banking, to enterprise customers. This makes SoFi a useful case study, in our opinion, as it has all of the revenue sources we have mentioned thus far. In addition to lending and enterprise software, SoFi offers digital banking, securities trading, robo-advisory, among other services. Its stated goal is to provide one-stop shopping to consumers of financial products.

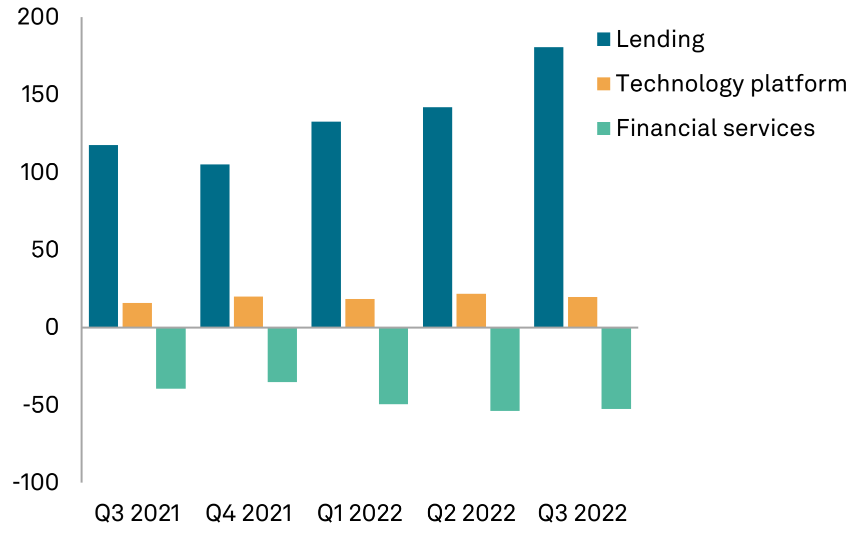
Based on its segment results, the plain vanilla business of lending is the most lucrative for SoFi. Its Lending segment — which comprises its home loans, student loans and personal loans — not only generates the most operating income, it has the highest operating margin; the Lending segment's margin averaged 54% over the past four quarters, versus 29% for the Technology platform segment and a negative margin for the Financial services segment.

The Technology platform segment comprises the aforementioned enterprise software solutions, which were bolstered by the acquisitions of Galileo and Technisys. The Financial services segment includes the digital suite of non-lending services SoFi offers, including digital banking and investing, as well as the referral fees from Lantern.

While SoFi is just one data point, we think they are a particularly insightful one, since they are one of the largest and well-known banking tech startups of the past decade and they are experimenting with many different business lines.

Based on SoFi's results, lending seems the best option for the current crop of neobank startups. Perhaps ironically, the more neobanks become traditional lenders and hold loans on their books, the more they start to resemble the incumbent institutions they were trying to disrupt. At that point, the key differentiators, we think, are the appeal of their user interfaces and their use of back-end technology for data analysis, open banking and automation.

Lending accounts for the majority of SoFi's operating income ($M)



Data compiled Jan. 4, 2023.
Amounts are reported by SoFi as "contribution profit" and are calculated as total net revenues for each segment minus expenses directly attributable to the corresponding reportable segment. The Lending segment's totals also exclude fair value changes in servicing rights and residual interests classified as debt that are attributable to assumption changes.
Source: S&P Global Market Intelligence.

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[2023 U.S. Banking Technology Market Report – Data Exhibits]
[The Big Picture: 2023 outlook for US Financial Institutions]
[Deposits waking up, betas rising as liquidity pressures emerge]
[Fintech partner banks bucking industry deposit trends]
[Outliers in chartered fintech banks' profitability metrics show complexity]
[Banks active in digital assets challenged by crypto-related deposit outflows]
[Headwinds to dealmaking remain persistent]