INSIGHTS FROM THE BDO FINTECH PRACTICE

Assessing Exit Strategies During Uncertain Times

BDO

Secondary markets and initial public offering (IPO) viability were strong at the end of 2021, making a wide array of opportunities available for fintechs. With ongoing market instability and rising interest rates, however, valuations cooled off in 2022 and venture capital (VC) funding saw a steep decline globally. The fintech sector, in particular, **was down 38% in 2022** compared to the previous year.

As VC funding continues at a slow pace and the IPO route remains challenging for many, fintech companies are reassessing their strategies. For those keenly interested in an IPO, now is an ideal time to start preparing. Since readying to IPO can take up to two years, fintechs can use this time to prepare before the window reopens. At the same time, many others will look toward alternative exit strategies, which are gaining traction in the current market. Two potential strategies that fintechs may consider are acquisition by a PE buyer or by a larger company.

Looking ahead, however, there are signs that **deal activity is going to pick back up in 2023**. **As prospective buyers show renewed interest in dealmaking, it is more important than ever for fintech companies to be strategic and compelling marketers in order to attract attention in a competitive fintech deal market.**

MAKING A COMPANY STAND OUT

No matter which strategy a company chooses to pursue, it is important for fintech leaders to understand how to appeal to different buyers. There are many factors that can influence valuation and attractiveness:

- **Financial indicators**, including working capital, profitability, tax considerations, and both capital and non-recurring expenditures
- **People and talent**, including a motivated management team and a strong company culture
- **Sustainability considerations**, especially as environmental, social and governance (ESG) strategy rises in priority

GOING THE PE ROUTE

With PE deals in fintech expected to increase over the next four years, PE firms have shown a strong interest in companies with a variety of product offerings. This may include:

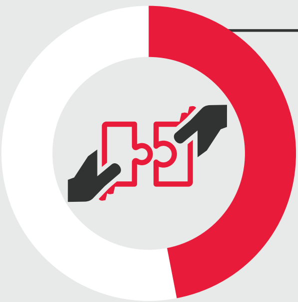
- Embedded finance (integrating financial products into a company's website or app)
- Payment tech
- Insurance and wealth-management tech
- Business-management software (with integrated payment capabilities)
- Software targeting CFOs
- Banking software

More broadly, two notable areas of focus for PE fund managers are B2B technology, due to their likely profitability and longevity; and public companies considering going private, given the current decreased valuations in public markets.

PROVIDING SOLUTIONS TO PE FUND CHALLENGES

BDO's **Private Capital Pulse Survey** from spring of 2022 identified several challenges facing PE funds throughout the deal cycle. Understanding the hurdles that PE funds are contending with is the first step for fintechs to make sure they look like the most attractive solution.

VALUATION ALIGNMENT



CHALLENGE:

47% of PE fund managers noted their biggest obstacle for closing deals was **gaps between buyer and seller valuation expectations**.

SOLUTION:

Having financial statements audited by a third-party partner goes a long way toward aligning with potential investors during the diligence process. The right partner can also advise on a fintech's competitive valuation.

PERFORMANCE IMPROVEMENT

CHALLENGE:

47% of PE fund managers face post-acquisition issues around **performance improvement, cost reduction, and revenue enhancement**.

SOLUTION:

Fintechs that identify performance improvements ahead of the buying process may be in a better position to exit on favorable terms. In-depth process reviews and refinements, done with the help of experienced, third-party industry professionals, may enable fintechs to identify those performance improvements. In addition, data analytics tools can provide key insights that further enhance efficiencies.

ESG CRITERIA

CHALLENGE:

94% of PE fund managers* expressed that their limited partners (LPs) want them to incorporate **ESG criteria into their investment strategies**.

SOLUTION:

Fintechs should be able to showcase if and how they are weaving ESG considerations into their business strategies. This would mean clearly articulating, measuring and reporting how ESG risks and opportunities factor into the business strategy, as well as indicating the role that ESG commitments and initiatives will play in the company's long-term growth. Fintechs should come with data to back up their claims. Companies with an intentional ESG focus or offering may have a competitive advantage, as 50% of PE fund managers noted they plan to invest in targets with ESG-focused themes.

*this figure comes from the Spring 2021 Private Capital Pulse Survey

LOOKING TO LEARN MORE ABOUT THE STATE OF THE PRIVATE CAPITAL MARKET?
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GOING THE ACQUISITION ROUTE

Smaller fintechs are most likely to be acquired by larger companies seeking targets that fit neatly into their overall product offering. Similar to PE firms, larger fintechs value lean targets who are already profitable, efficient, and prepared for a robust diligence process. These larger companies are often compelled by:

- Motivated talent and a stable recruitment pool
- Uniquely valuable product offerings and value propositions — especially those that could help customers during a recession
- Strong financial performance and data-backed growth projections

This last point is notable — strategic buyers are looking for immediate financial gain. Strong financial performance and future revenue growth is extremely attractive to these buyers, and they are willing to bid aggressively for fintechs that may provide financial gain. In fact, 53% of PE fund managers said strategic buyers will represent the majority of their deal competition.

For fintechs going the acquisition route, it is critical to market the immediate value provided by products and services, as well as the growth potential. One area to highlight is alignment — where a smaller company's offerings can directly tie into a potential buyer company's existing core competencies.

PREPARE TO BE EVALUATED

Fintechs that are prepared for the sales process will be in a stronger position to find the best buyers and execute the strongest deals regardless of whether buying activity is up or down. Companies can boost buyer confidence with prepared documents that provide insight into their day-to-day operations and long-term growth potential. Topics to address are:

- Accounting
- Tax
- Operational procedures
- Key points related to IT and HR

Smaller fintechs may encounter more difficulty preparing the documents buyers need given limited resources and fewer staff. Enlisting an outside provider to assist the sales team can help ensure deal-relevant materials are delivered in a timely, organized and complete manner.

Since the public market and/or preparing for IPO early will not be a suitable strategy for many fintechs, PE and larger fintech buyers are interested in identifying smaller fintech companies looking to exit in this challenging environment. The key to successfully securing an exit in the private market comes down to understanding why different buyers acquire different fintechs — and how to appeal to each of these buyers.

While this requires careful planning and consideration, having financial statements, tax records, best in class processes and audits backed by a reputable third-party firm can make all the difference to a potential buyer.

QUESTIONS ABOUT PREPARING FOR AN EXIT?
Contact BDO today ▶

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