Business Valuation INTERNATIONAL

BVINT- NEWSLETTER JUNE 2020
EDITION 06, JUNE 30, 2020

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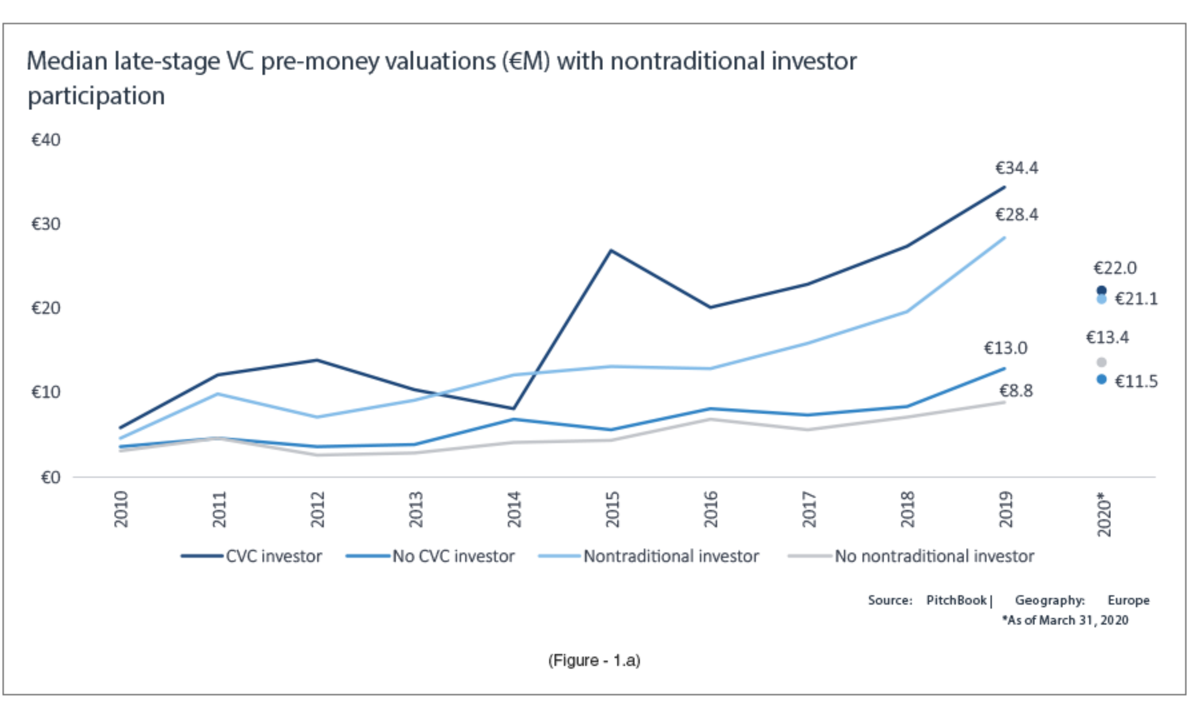
Index

1. COVID19 Impact on Start-ups and Venture Capital Valuations

1.1 Venture Capital Valuations During Q1 2020

According to Pitchbook, in Q1 2020, pre-money valuations across the financing stages remained resilient amid the emergence of COVID-19. However, most VC deals were conducted prior to disruption, and valuations are expected to decrease in the next months:

- Non-traditional investment is likely to decrease, adding to downward pressure on VC deal sizes and valuations.
- Non-traditional investors will tend to focus on their primary markets instead of VC during the looming downturn.
- Aggregate unicorn value growth has been strong, but this may slow. Valuations of high-profile loss-making unicorns could come under scrutiny as avoiding funding gaps and resource management become imperative. The bottom left picture shows that Value generated from unicorns in the European VC ecosystem has progressively improved during the last decade and continued in Q1 2020. But as we enter a downturn, swelling unicorn valuations are expected to face fresh challenges and could see some of the largest drops. Furthermore, valuations of high-profile loss-making unicorns could come under examination as cash squeezes ensue and resource management becomes imperative **(see next section where we compare Revolut and Monzo before and after COVID19).**
- Unicorn valuations are likely to flatten or fall as growth becomes harder to capture in the current environment **(see next section where we compare Revolut and Monzo before and after COVID19).**
- Exit valuations continued to fall in Q1 2020, and COVID-19 will drastically reduce the number of exits.
- Mature startups will seek out follow-on and extension rounds to stretch runways rather than an exit.
- Exit opportunities will be further hindered by volatility in public equities and strategic acquirers facing financial problems.



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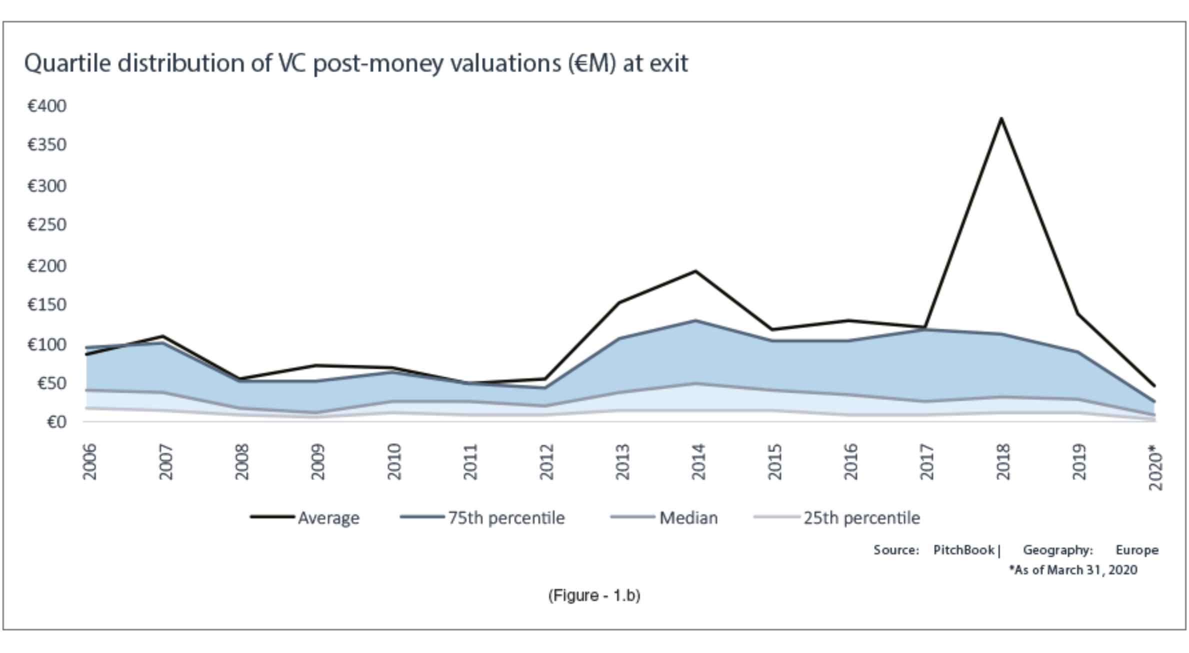

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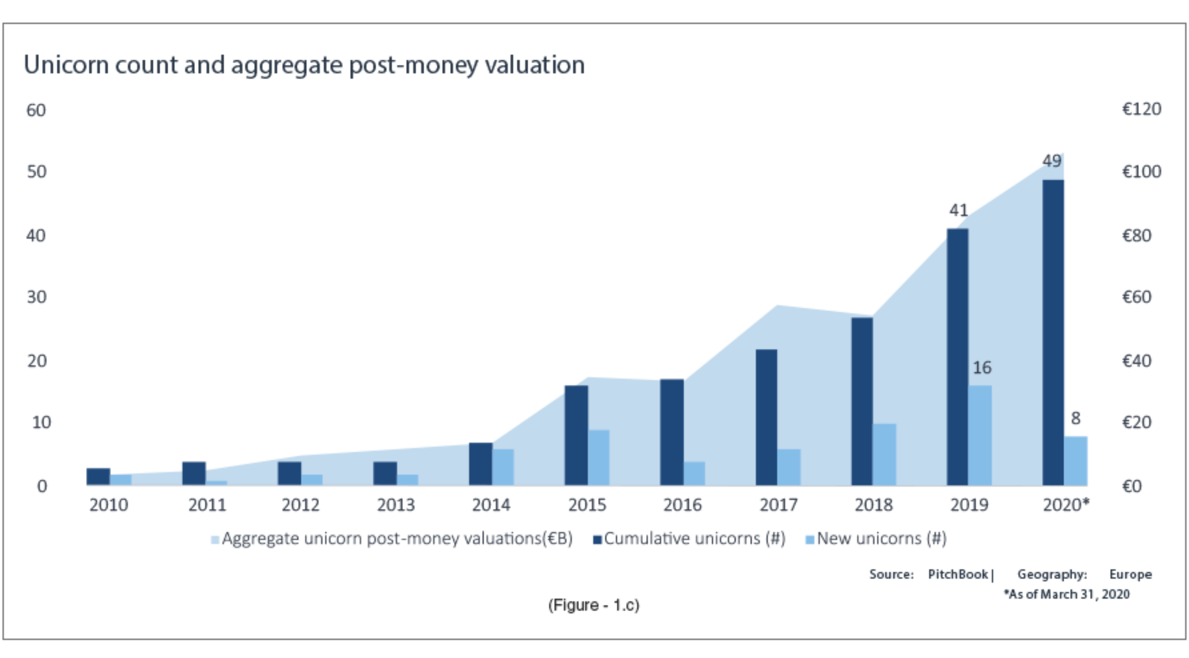

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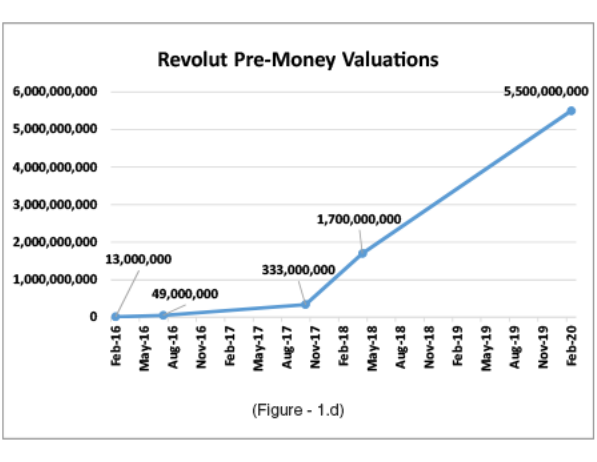
1.2 Before and After COVID19: Revolut and Monzo Valuations

UK challenger bank Monzo is reportedly raising (June 2020) a fresh round of cash from investors at a 40% discount to its previous fundraising. The fintech is close to sealing a deal that will value it at ca. £1.25bn, compared to a valuation of £2bn at its previous funding round in June 2019, according to the Financial Times.

The drop in its valuation comes in the context of the COVID19 pandemic as venture capital firms become increasingly cautious about investing in loss-making businesses. The money raised is being sourced from both new and existing investors. Key backers of Monzo include US venture capital groups Y Combinator Continuity, Accel and Goodwater Capital, along with UK-based Passion Capital.

Monzo has furloughed some staff due to COVID19 lockdown (the Bank is axing up to 120 jobs) and in March the CEO Tom Blomfield said he would forgo his salary for 12 months. However, it still has its sights set on growth and last month applied for a US banking licence as it looks to expand across the Atlantic. It could take Monzo between 18 months and two years to have its application approved.

The Venture Capital Sifted said that Monzo had been overly optimistic with its £2bn price-tag last year and said down rounds were a natural consequence of "raising at such a high number". Additionally, Several investors said that Monzo and its peers had been struggling with "challenger bank fatigue" among wary investors, delaying the raise even before the UK lockdown took hold.



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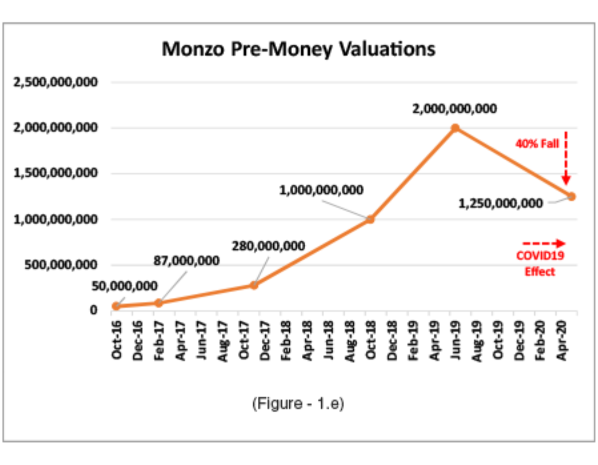


(Figure - 1.e)

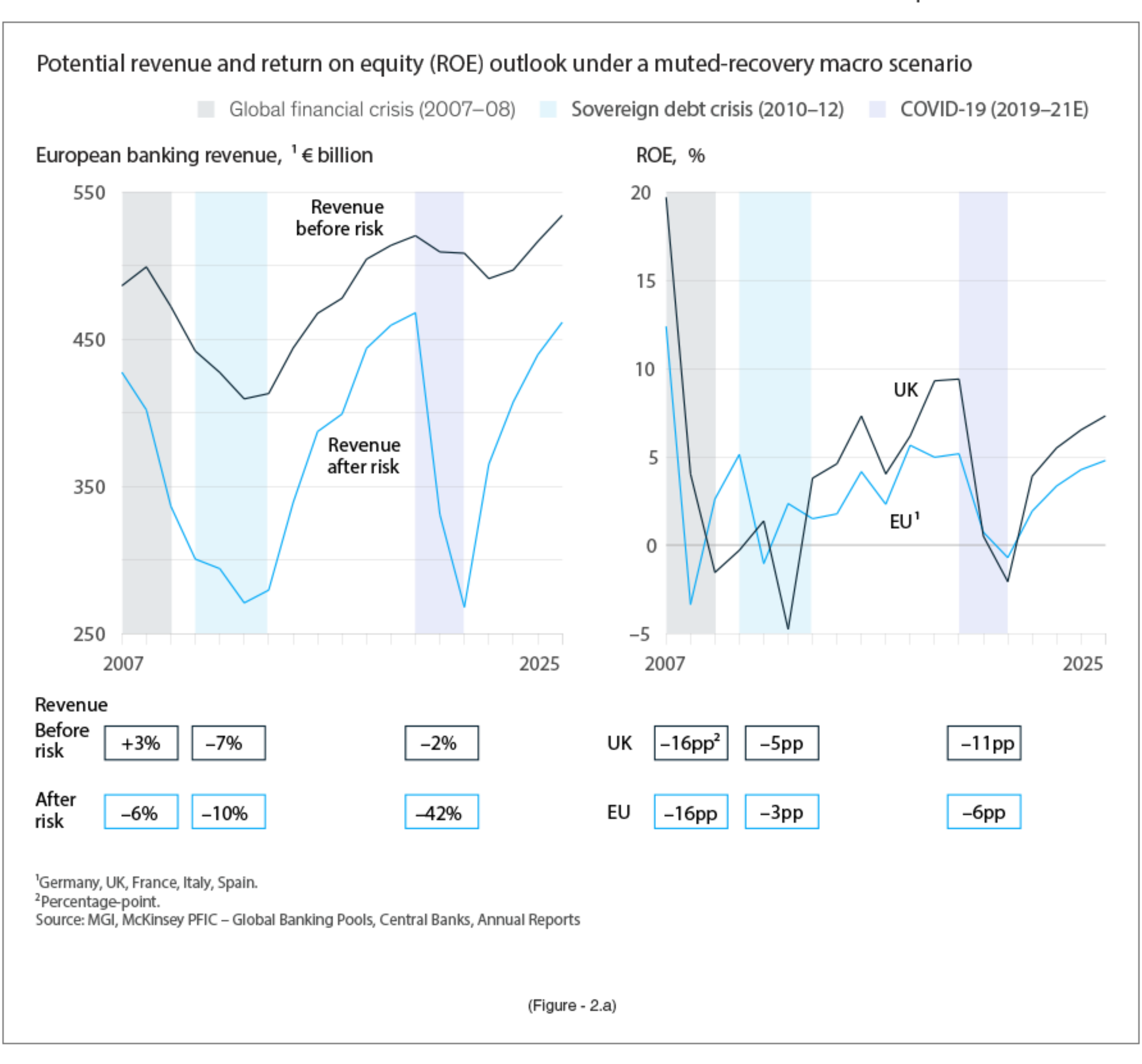
We believe that fintech unicorns would likely see an average of 15% wiped off their individual valuations and down rounds are not a reliable indicator of a company's future.

2. The Future of the Banking Sector after COVID19

2.1 COVID19 Impact on the Banking Sector

In the coming months, banks will start to return to something resembling normal service, reopening offices and branches. But so much has changed over the past few weeks: customers' financial needs, the way they engage, how employees work, and even society's expectations of banks. There is no going back.

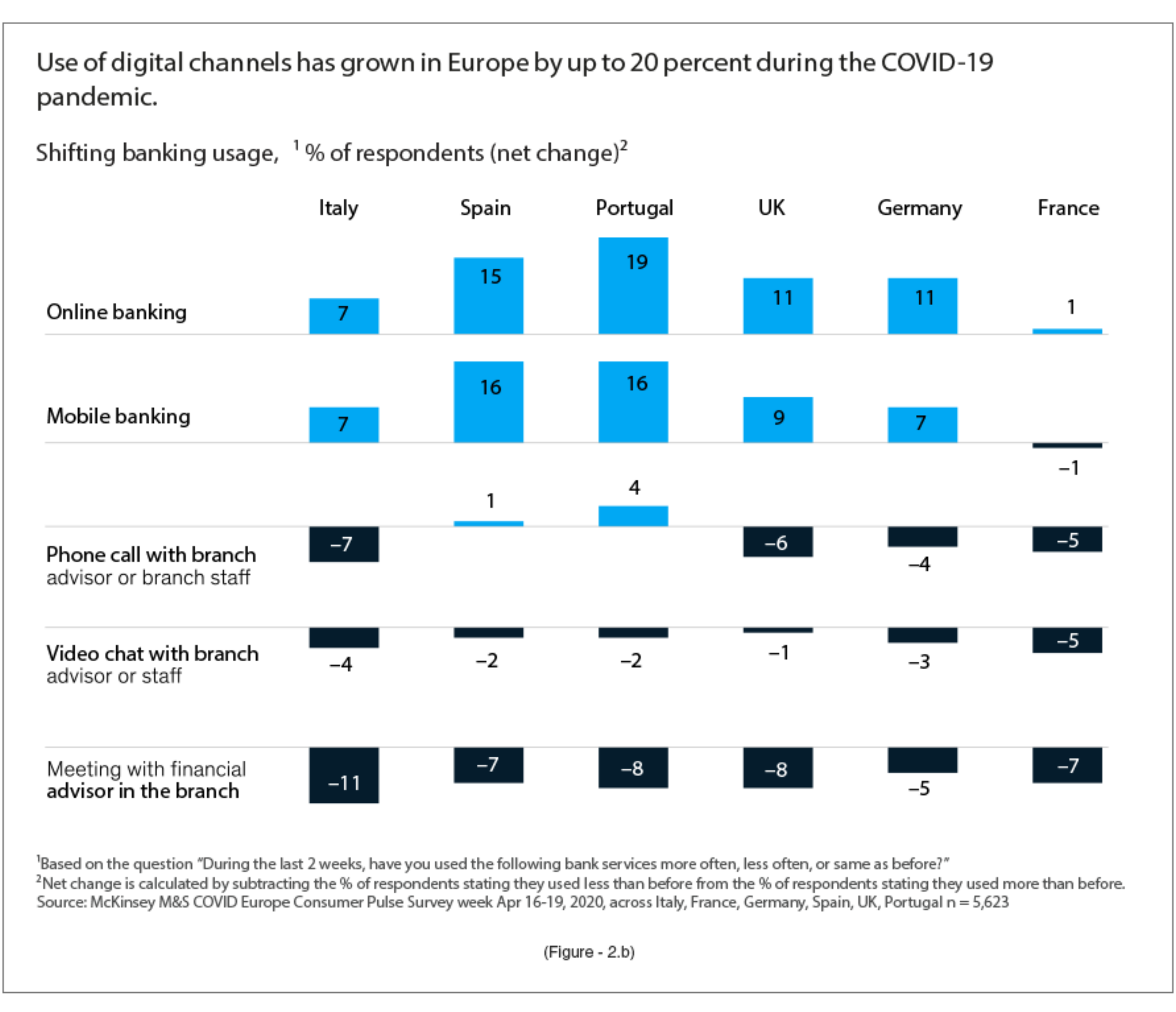
According to a study conducted by McKinsey, revenues could fall by more than 40%, with recovery to pre-crisis levels only in 2024. As a consequence, the banking sector could lose four years of economic progress. This scenario would therefore be more severe for banking economics than the 2007–08 financial crisis or the 2010 European debt crisis.



(Figure - 2.a)

2.2 How to Recover and Win

- **Digitalization:** According to statistics, there is circa a 20% rise in digital banking use across Europe in April. In Europe, where new digital banks accounted for more than a third of banking revenue growth since 2005, app downloads for challenger banks have dropped precipitously over the past two months. Investors backing these unicorns have pulled back support too, with VC funding falling to a two-year low. Part of the fintech challenge is that in times of uncertainty and stress, traditional banks are seen as a safe haven. So COVID-19 is presenting the traditional banks with an opportunity to play catch-up and close the digital gap.
- **Product Innovation & Customization:** Due to the fact that COVID19 triggered new financial needs, banks need to strengthen their advanced analytics skills and artificial intelligence (AI) to identify which customers they can feasibly serve in order to create a more personalized offer and customized service.
- **Cost Reduction:** Banks need to aim for a cost improvement. The following strategies should be considered:
  - Pay-as-you-go Models
  - Increase Digitalization
  - Reduce Central Functions
  - Transform Technology (cloud-based platforms)
  - Reduce offices and Keep Remote Working
  - Flatter Management Structure
- **Improve Risk Management Tools:** Banks need to develop advanced and sophisticated digital credit decisioning systems to improve both speed and performance. Early detection and proactive intervention are critical to manage non-performing loans. Advanced risk systems including predictive analytics and probabilistic analysis should be adopted by banks in the near future.
- **Acquisition of Economies of Scale and Skills:** M&A is a good strategy to create economies of scale and acquire new skills. European challenger banks and fintech valuations already dropped between 10% and 40% after COVID19. As a consequence, traditional banks could acquire these innovative concepts and scale them rapidly.



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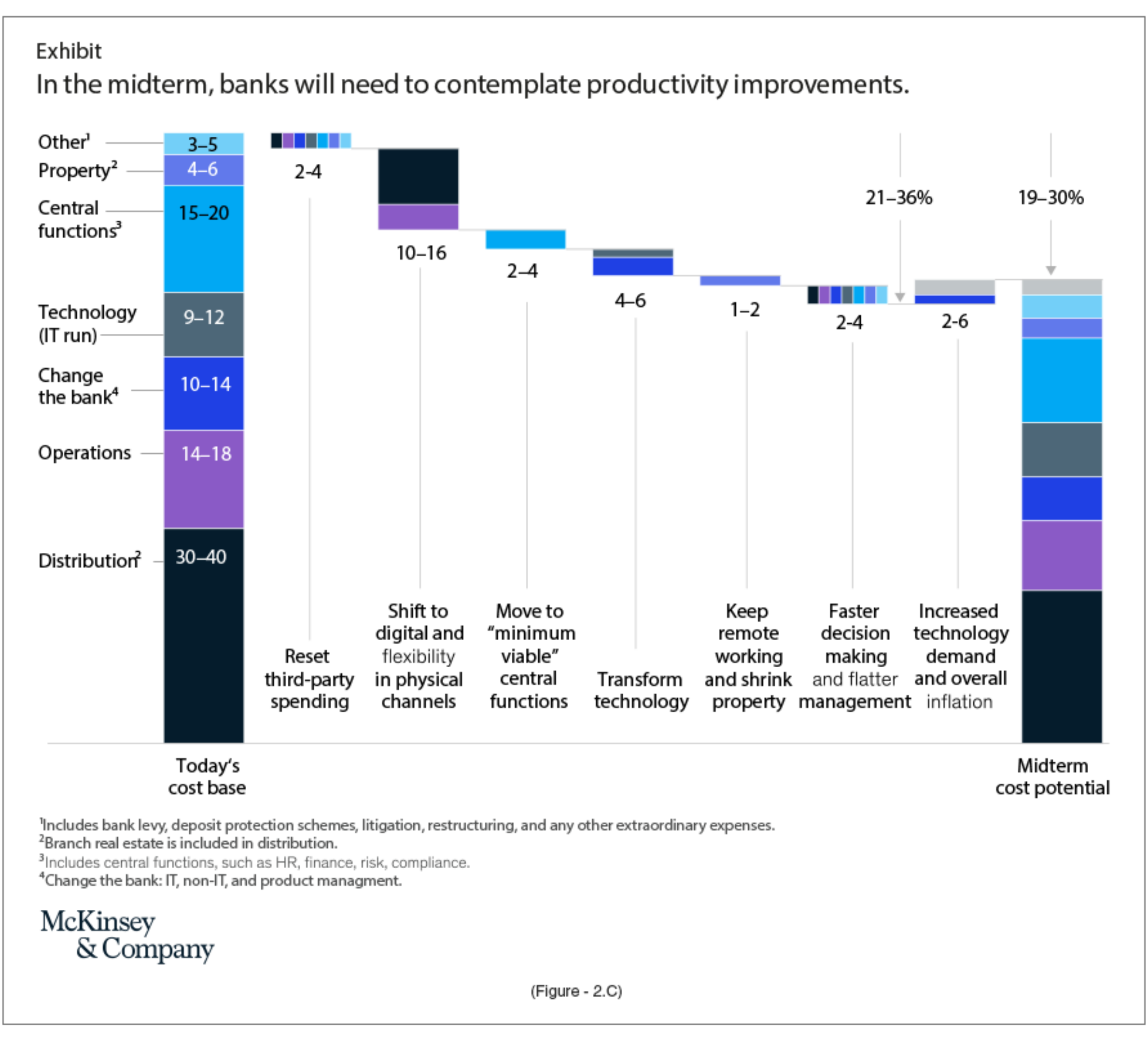

(Figure - 2.C)

More than half of banks already had ROE lower than their cost of equity (McKinsey's Global Banking Annual Review 2019)

COVID-19 is presenting the traditional banks with an opportunity to play catch-up and close the digital gap.

This is the time to update your valuation and review your strategy. A valuation report is the best tool to understand markets, trends, risks, value drivers and reformulate your strategy. Start now!

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