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Understand the Value of Your Payment Company

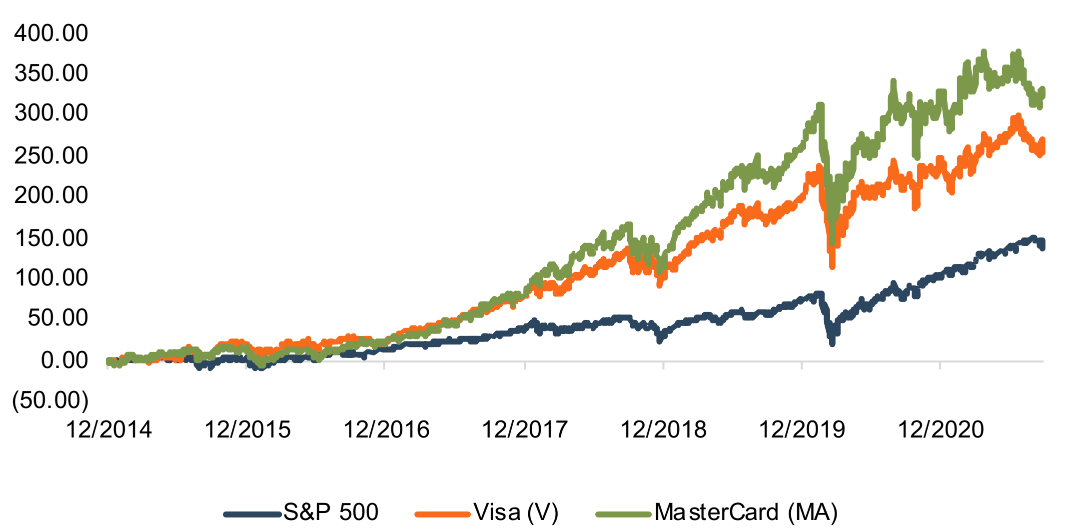
When it comes to emerging sectors of the economy, FinTech companies remain in the spotlight. FinTech companies seek to improve inefficiencies in the financial services industry. COVID-19 accelerated these efforts as legacy problems became impossible to circumvent in the environment that the pandemic created. Valuing FinTech companies can be a complex exercise as their market opportunities can be evolving, and their cap tables are often complex. This complexity can be a result of venture capital, corporate, and private equity investors being cobbled together across a number of funding rounds.

Throughout this whitepaper, we look into the payment industry's place in the larger FinTech ecosystem, macroeconomic factors driving the industry, microeconomic factors pertaining to specific companies, and what valuation methods are most prudent when determining the fair market value of a payments company.

Payment Companies: An Overview

When thinking about the overall FinTech landscape, many think of payment companies first since digital payment products are used frequently by both consumers and businesses as we use physical cash and checks less frequently. Furthermore, the payments branch of FinTech is more mature than some of the others, with Visa and Mastercard, two of the largest payment companies, having been around since the 1960s. As discussed in Chapter 3 of "**Creating Strategic Value Through Financial Technology**," Visa and Mastercard were both formed by banks, with the latter established as a competitor to Visa, which was formerly known as BankAmericard. Both companies went on to grow and reward many of their early shareholders, a number of which were banks, and ultimately became two of the largest IPOs in FinTech history, going public in 2008 and 2006, respectively. They continue to be huge players in the industry and have had total returns that largely outpace the overall market (as seen in the chart below).[1]

Total Return (%)



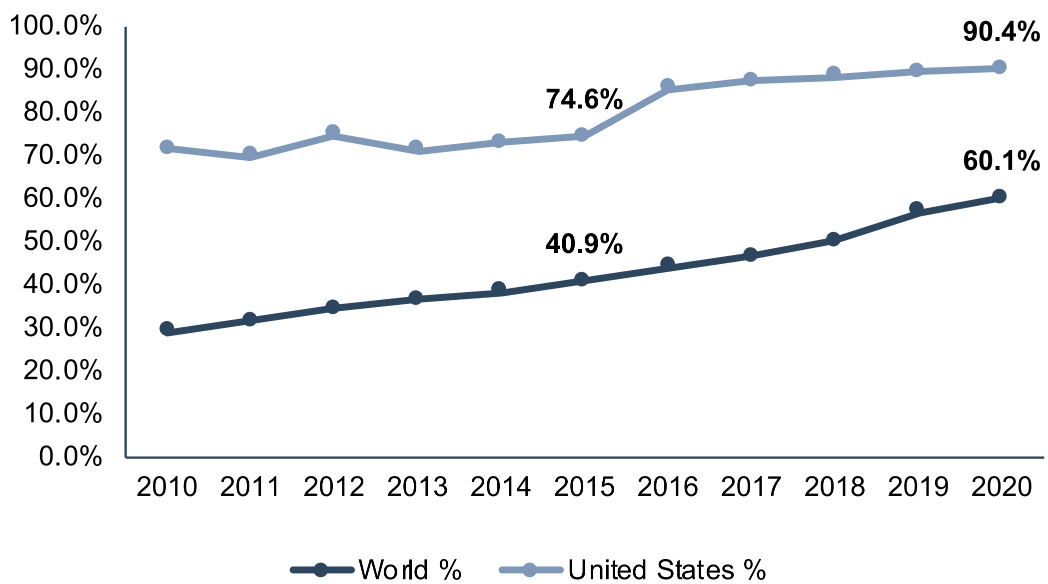
Source: S&P Capital IQ

[1] For more information on FinTechs and how they can boost innovation and enhance valuation for traditional financial institutions, Jay Wilson's book, "Creating Strategic Value Through Financial Technology" is linked **here**.

Payment companies have come a long way since the Visa and MasterCard IPOs. While the COVID-19 pandemic propelled the industry years into the future as cash transactions and in-person shopping declined due to virus concerns, the payments industry has been growing steadily for years now.

There are some key elements behind the expansion of payment companies over the past years, including the rise of internet/mobile access and ecommerce. As of April 2021, more than **332 million** people came online globally for this first time, taking the number of global internet users to 4.72 billion in total. This represents 7.5% growth over the prior 12 months, and now over **60%** of the world's total population is online. In the United States, **90%** of the population is online. For perspective, in 2015, those percentages were **41% (world)** and **84% (U.S).** There are projections of total worldwide internet access reaching **90%** of the population by 2030, with nearly **three quarters** of the population accessing the web solely via their smartphone by 2025.

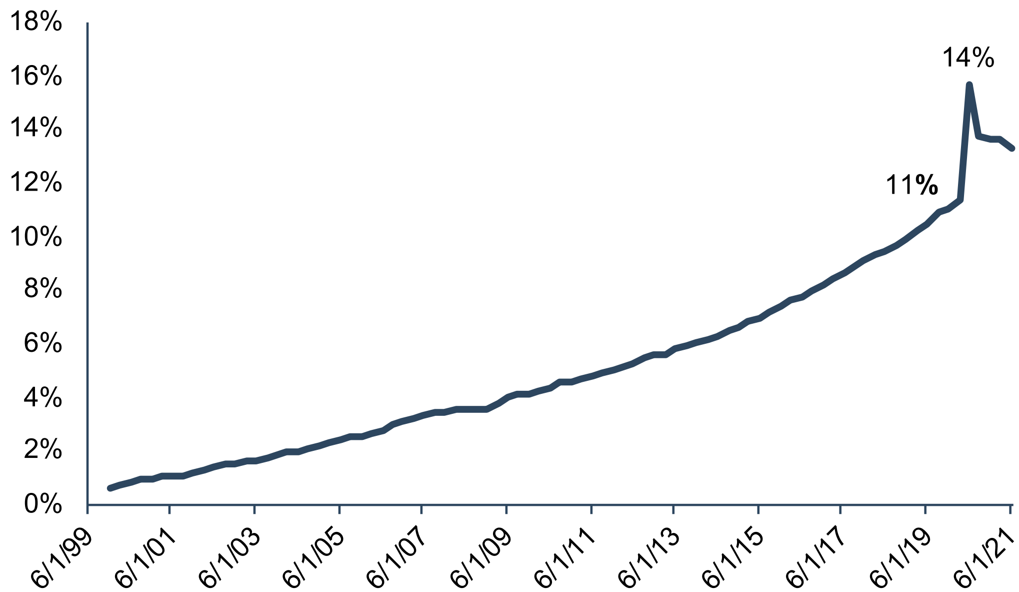
Internet Access (Per % Population)



Source: World Bank and Datareportal

With more people having access to the internet, more people also have access to ways to spend and make money via that connection, leading into our next key driver: the rise of ecommerce. According to UN trade and development experts **(UNCTAD)**, the United States saw a spike in the share of online retail sales as a percentage of total retail sales, increasing from 11% in 2019 to 14% in 2020.

E-Commerce as a % of Total Retail Sales

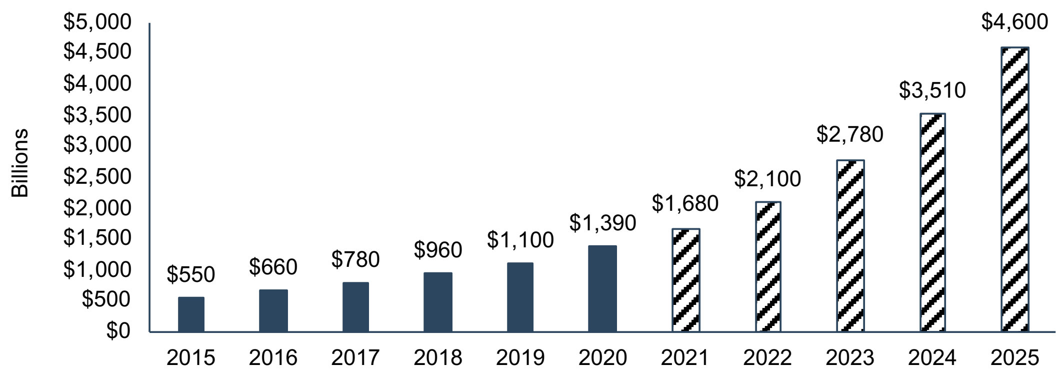


Source: United States Census Bureau

Though this growth in 2020 is partially attributable to the COVID-19 pandemic, the surge in ecommerce has been percolating for years now, as household technology access continues to improve, and online retailers are able to offer more variety and quicker checkouts than traditional brick-and-mortar stores. For perspective, per the Walmart corporate website, typical supercenters offer around **120,000** items. In comparison, the number of products that Amazon has to offer through their online retailer is a whopping 12 million. That is 100x more products than can be found at Walmart. The larger availability of choice with online retailers has been a major drive of online spending. Further, digital payments have increasingly spread beyond retail and into other segments/niches of the economy (P2P, healthcare, B2B, hospitality/tourism).

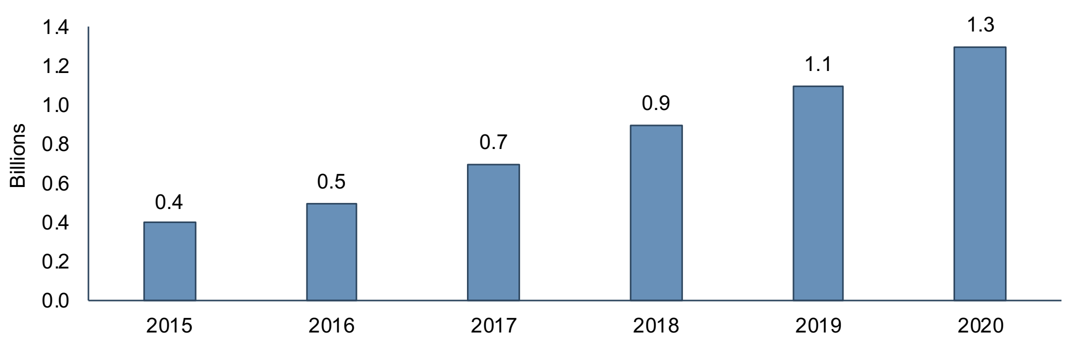
With more access to the internet and more opportunities to purchase and sell items online, the need for payment companies to facilitate transactions in this space has grown dramatically, and hence, led to the boom in payment companies. As seen in the charts on the next page, global payment revenues and users have been increasing steadily over the historical period considered, and projected growth is significant. Revenue has grown at a CAGR of 20% from 2015 to 2020, and grew 26% in 2020 alone, assisted by the demand for digital payments as a result of the COVID-19 pandemic. Looking forward, total revenue is anticipated to reach $4.6 billion by 2025. Total number of users follows this trend, having grown at a **CAGR of 27%** from 2015 to 2020.

Global Mobile Payments Revenue



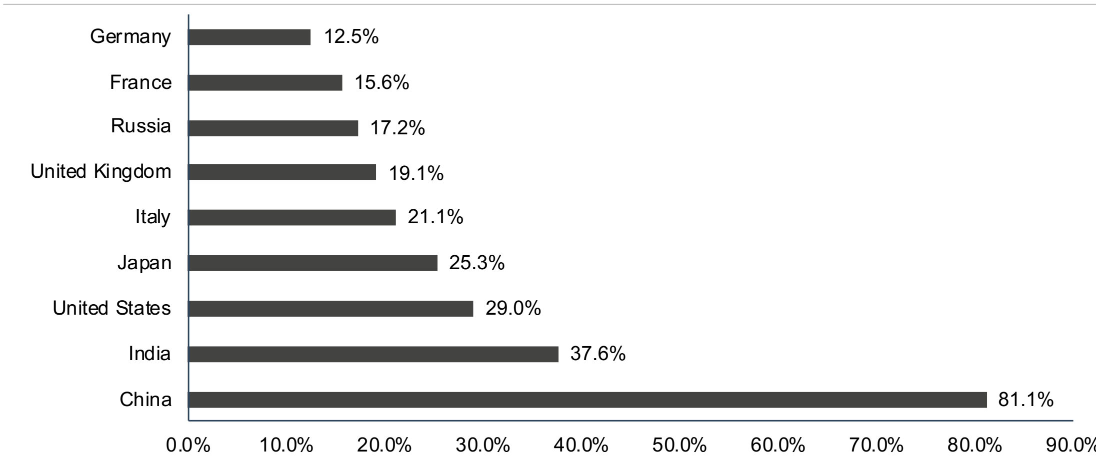
Source: www.BusinessofApps.com

Global Mobile Payments Users



Source: www.BusinessofApps.com

Monthly Payment Adoptions by Country



Source: www.BusinessofApps.com

Notably, China has the **largest market share** of both revenue and users and over half of total global payment users are located there. China is currently also leading the way, globally, in terms of mobile payment adoptions, with an **81.1% adoption rate**. For reference, the United States has a 29.0% adoption rate.

While China is clearly in the lead in terms of development and production of "super-apps," the U.S.-based race for a similar offering is just heating up. Currently, the main contenders for the title are PayPal and Square. PayPal is a market leader and already expecting to process a record of **$1 trillion payments** in 2021. On a recent earnings call, CEO Dan Schulman announced roll outs to seamlessly do everything from buy groceries to donate to charity. Furthermore, Schulman is targeting "half a billion to one billion people, minimum." PayPal doesn't have an open road absent competitors however, with Square also vying for a super-app position. Currently, **more than 40 million people** use Square's Cash App. That comes out to roughly one in eight Americans. Like PayPal, Square has also been implementing new features such as "Direct Deposit" which gives employees access to wages as soon as their shift has ended and allows users to get their tax refund up to two days early.

Market Considerations

In order to determine the valuation of a payment company, a number of considerations can be important and we will only discuss a few common ones. One key consideration is the total addressable market for the FinTech company, which is often impacted by understanding larger macroeconomic factors and how they may impact the payment company's target market.

Additionally, the regulatory and compliance environment can play an important role in determining a value for the payment company. Financial services are heavily regulated, so understanding rules and laws is important for developing an accurate valuation. Furthermore, certain regulatory environments promote growth, while others are more hindering. This is important to consider when analyzing the overall growth prospects for a company.

A recent example of the impact that the regulatory environment can have is scrapping of Visa and Plaid's $5.3 billion FinTech deal. As mentioned previously, Visa continues to be a large player in the FinTech space and the acquisition of **Plaid**, a FinTech company that connects users' bank accounts to apps and services, would have positioned the largest credit and debits payment network in the U.S. to further its market share. The deal was proposed in January 2020, and the **$5.3 billion price tag** was at the time two times more than Plaid's most recent valuation and would have made it one of the largest FinTech deal's in history. However, the Department of Justice sued to **block the acquisition** over concerns that it would harm competition in the global market. If the Plaid deal would have gone through, Visa would have gained access to **200 million** consumer bank accounts and 2,600 financial technology apps, some of these such as Venmo, Visa already competes with in the payments space. As a result of the lawsuit, the companies shuttered the deal at the **beginning of 2021**. This result is a great example of why observing the regulatory space is important when determining a company's value. With the deal shuttered, both Plaid's outlook and valuation are impacted and path to exit is limited, for better or for worse (Plaid's valuation hit **$13.4 billion** in April of 2021).

Besides governmental regulations and total addressable market, other key issues to understand can include competitors, market/valuation trends for that niche, and growth prospects.

Company Considerations

When valuing an early-stage payments company, quantitative historical information (financial and operating history) may be limited. In those situations though, it is not sufficient to look at the overall market environment only and assume just because a certain payments niche is attracting high valuations, that a specific company in that same niche would follow the same trend. In these cases, qualitative company-specific information can be important in determining a company's value and below we discuss three common areas that can drive valuation.

- **Management Team.** Knowledge and payments industry experience from the management team including understanding customer preferences, technology integration, the competitive environment, and the regulatory environment can enhance a payment company's company value.

- **Intangible Assets Such as Technology.** A payment company's intangible assets such as developed technology, ownership of intellectual property, and other intangible assets, like strategic partnerships or tradename, could also be an important consideration.

- **Stage of Development/Milestone Trajectory.** Milestones are important to set and track as the more milestones are met, the less uncertainty and risk exists around the technology viability and business model and the more value is created as future growth targets become more likely and closer to being realized. Milestones often vary but can include initial round financing, proof of concept, regulatory approval, obtaining a significant partner, reaching profitability or other growth metrics, and more. For example, a payment company with established technology, increased customer touch points/partnerships, and the potential to increase revenues and scale will be more valuable to a potential acquirer or investor than a newer startup that hasn't reached those milestones. In addition, meeting later stage milestones often provides greater value than meeting early-stage milestones. When the valuation considers future funding rounds and the potential dilution from additional capital raises, a staged financing model is often prepared and the valuation will vary at different stages and as milestones are accomplished as shown on the next page.

Enterprise Value Indications ($Million)	$25.0	$35.0	$88.0	$120.0	$175.0
Development Milestones	Product Development, Customer Traction & Retention, Regulatory Process	Expand Partnerships and Customers, Satisfy Regulatory Req., Attract & Retain Customers	Complete Early Ramp-Up; Achieve Wider Market Acceptance	Achieve Market Potential, Greater Efficiency and Profitability	
Incremental Solutions	*Market Testing / Prod. Development*	*Gain Traction / Retain Customers*	*Complete Early Ramp-Up*	*Achieve Market Potential*	
Pre-Money Value	$25.0	$35.0	$80.00	$120.00	$175.0
Assumed Funds Raised	$5.0	$7.0	$16.0	$24.0	$52.0
Post-Money Value	$30.0	$42.0	$96.0	$144.0	
% Ownership After Funding	80.0%	64.0%	51.2%	41.0%	
Implied Valuation Step-Up		**1.17x**	**1.90x**	**1.25x**	**1.22x**

(Upon Achievement of Development Milestones)

Valuation Approaches

When valuing a company, there are typically three approaches utilized in determining value: asset, income, and market. While each valuation method is typically considered when valuing a company, certain characteristics of the company and industry could make the weighting and importance of the approaches differ. Choosing the right considerations of these valuation approaches is crucial in determining an accurate valuation for the company and, ultimately, the positions of the stakeholders within the company.

The Asset Approach

The asset approach determines the value of a business by examining the cost that would be incurred by a relevant party to reassemble the company's assets and liabilities. This approach is generally inappropriate for FinTech companies in the payments niche as the historical cost to develop the technology may not be indicative of the revenues and cash flows that can be generated in the future from it. However, the asset approach can be instructive to consider the potential costs and time that the company has undertaken in order to develop proprietary technology and other intangibles.

The Income Approach

The income approach can typically provide a more meaningful indication of value for a FinTech company. This relies on considerations for the business' expected cash flows, risk, and growth prospects. The most common income approach method is the discounted cash flow (DCF) method, which determines value based upon the present value of the expected future cash flows for the enterprise. The DCF method projects the expected profitability of a company over a discrete period and prices the profitability using an expected rate of return, or a discount rate. The combination of present values of forecasted cash flows provides the indication of value for a specific set of assumptions.

The length of this discrete period over which the expected profitability is considered may vary depending on the characteristics and development stage of the payment company. For example, for a relatively new payment company startup, that is still burning cash and has yet to break even, the discrete period may be longer than a more established company that has already achieved positive cash flow. Additionally, if a payment company has certain products on the horizon and it will take longer for those products to reach their total profit potential, the discrete period would need to be adjusted to capture this. A good rule of thumb is for the discrete period to be long enough for the company to reach an assumptive "stable growth level." Discount rates, funding/capital needs, and growth rates vary from company to company as well and can be affected by many different company characteristics such as management team, capital structure, region of operation, specific products, and customer base. A thorough examination of the subject payment company is important in making a reasonable assumption on these.

Unit economics (or unit metrics) are also an important consideration when valuing a payment company and forecasting cash flows. In the table below, we have labeled and defined some of the most important ones.

Unit Metrics Defined	
Rule of 40	A principle that a high-growth FinTech company's combined annual revenue growth rate and profit margin should exceed 40%
Magic Number	A measure of incremental gross profit (adjusted, if necessary) that equals annual revenue less prior year revenue divided by sales & marketing expense (lagged one period)
Customer Acquisition Cost (CAC)	Measures the direct cost to acquire a new customer
Customer Lifetime Value (LTV)	The estimated lifetime value of a customer
LTV: CAC Ratio	A measure of the lifetime value of a customer divided by the cost to acquire the customer
Churn	A measure of the attrition rate in customer accounts/revenue
Annual Recurring Revenue (ARR)	An estimate of the revenue under contract and expected to recur on an annual basis.
Annual Revenue Profit	Estimated by multiplying ARR by the estimated EBITDA margin for the company

Though these metrics do not provide an indication of value in their own right, they can provide more color to the actual state of the company and serve as a way to benchmark performance versus history and peer. These metrics can also serve as a foundation for future earnings forecasts, and also a test of reasonableness of the forecast.

For early-stage payment companies, cash flow forecasts are often characterized by a period of operating losses, capital needs, and expected payoffs as profitability improves or some exit event, like an acquisition, occurs. Additionally, investors and analysts often consider multiple scenarios for early-stage companies both in terms of cash flows and exit outcomes (IPO, sale to a strategic or financial buyer, etc.), which can lead to the use of a probability weighted expected return model (PWERM) for valuation.

The Market Approach

The market approach determines the value of a company by utilizing valuation metrics from transactions in comparable companies or historical transactions in the company like prior funding rounds. Consideration of valuation metrics can provide meaningful indications for startups that have completed multiple funding rounds but can be complicated by different preferences and rights with different share classes.

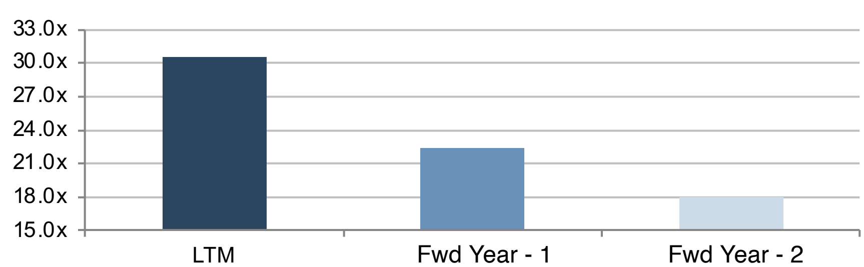
Regardless of complications, share prices can provide helpful valuation anchors to test the valuation range. Market data of comparable publicly traded companies and acquisitions can be helpful in determining key valuation inputs for payment companies. For early-stage companies, market metrics can provide valuable insight into potential valuations and financial performance once the payment company matures and considers exit opportunities. For already mature enterprises, recent financial performance can be compiled to serve as a valuable benchmarking tool. See the payment valuation multiple trends charts below as an example.

Payment Valuation Multiples as of 9/30/21

EV / EBITDA

Payment Valuation Multiples as of 9/30/21

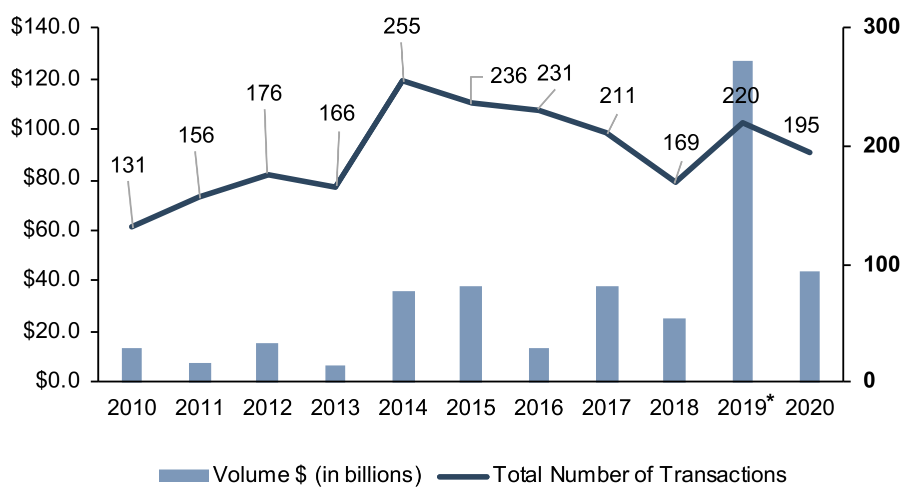
P/E Multiples



As mentioned previously, the payment company industry is marked by a large number of transactions which provide a lens on payment company values. Investors can discern how the market might value a payment company based on pricing information from comparable payment companies or recent acquisitions of comparable payment companies.

According to **FT Partners Q2 2021 Insights**, there were 122 global M&A transactions of payment companies with financing volume of $15.5 billion in the first half of 2021. This compares to **2020** when there were just 84 global payment company transactions with a similar volume of $15.9 billion. The chart below highlights historical payment company global financial volume and deal counts.

Global Payment M&A Volume and Deal Count



Source: FT Partners

**2019 M&A volume includes the acquisitions of Worldpay for $43 billion, FirstData for $41 billion, and TSYS for $25 billion*

Even when market data is available, discretion must be used when considering any guideline multiples and the market approach due to the unique nature and niche of many payment companies.

The Importance of Valuations

Given their complexity, multiple valuation approaches and methods are usually considered to provide lenses through which to assess the value of a payment company. It is important to note that these different approaches and methods are not expected to align perfectly. Value indicators from the market approach can be rather volatile and investors normally think longer-term. More enduring indicators of value can often come from income approaches, such as DCF models.

As discussed, there are many moving parts in valuing a payment company. Due to their complex nature, having an accurate valuation is critical to determine both an investor's specific value as it relates to their holding return on investment and position in their overall portfolio, as well as for management of the company to have an accurate idea of their current worth. In an industry rife with M&A opportunities, having an idea of an accurate and fair price for the company also gives shareholders a leg up as they consider strategic options and perhaps the sale of the company. For those companies still in the growth phase, valuations serve to provide a baseline measure of where the company is today and also serves as a measuring stick for benchmarking future performance/valuation. Given the complexities of valuing payment companies and private FinTechs in general, it is important to have a valuation expert who understands trends in both the market and the company.

FinTech Industry Services

Mercer Capital provides financial technology companies with valuation, financial advisory, and consulting services.

Services Provided

- Valuation of financial technology companies
- Financial advisory/valuations for acquisitions and divestitures
- Valuations for purchase accounting and impairment testing
- Fairness and solvency opinions
- Litigation support for economic damages and valuation and shareholder disputes
- Consulting and board presentations for corporate and strategic planning
- Unit economics analysis, studies, and consulting

FinTech Niche Experience

- Payments
- Digital / specialty lending
- Wealth Tech
- Digital / online banking
- InsurTech
- BankTech including RegTech

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