Regional analysis Fintech sector

Fintech Leaders In Region Follow Global Trends

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Industry highlights

Fintech industry attracted more interest with the need for de-centralized financial services becoming even more apparent during the pandemic. Innovative market entrants created novel platforms and infrastructures that engaged users through 24/7 accessibility, product diversity and low barriers to entry. Digitalized financial services are becoming the new norm and established market players are finding ways to adapt. Fintech disrupted the way legacy market players (banks and financial institutions) have been operating. Fintech covers a broad range of services such as payment products, (e-banking) banking, deposit and saving products, insurance services (InsurTech), money and budget management services, P2P lending and crowdfunding, digital assets (cryptocurrencies, NFTs, tokenized assets), and others. Principal market players include banks and other financial institutions, fintech start-ups, tech companies and payment processors.

Global IT spending is in constant increase, however spending on IT hardware takes the primary place having increased from share of 48% in 2006 to 64% in 2021 largely on the back of increased mobile device purchases. Although the share of software spending is stable around 18% over the last 16 years, the absolute amount of software spending is 3x higher to 2006.

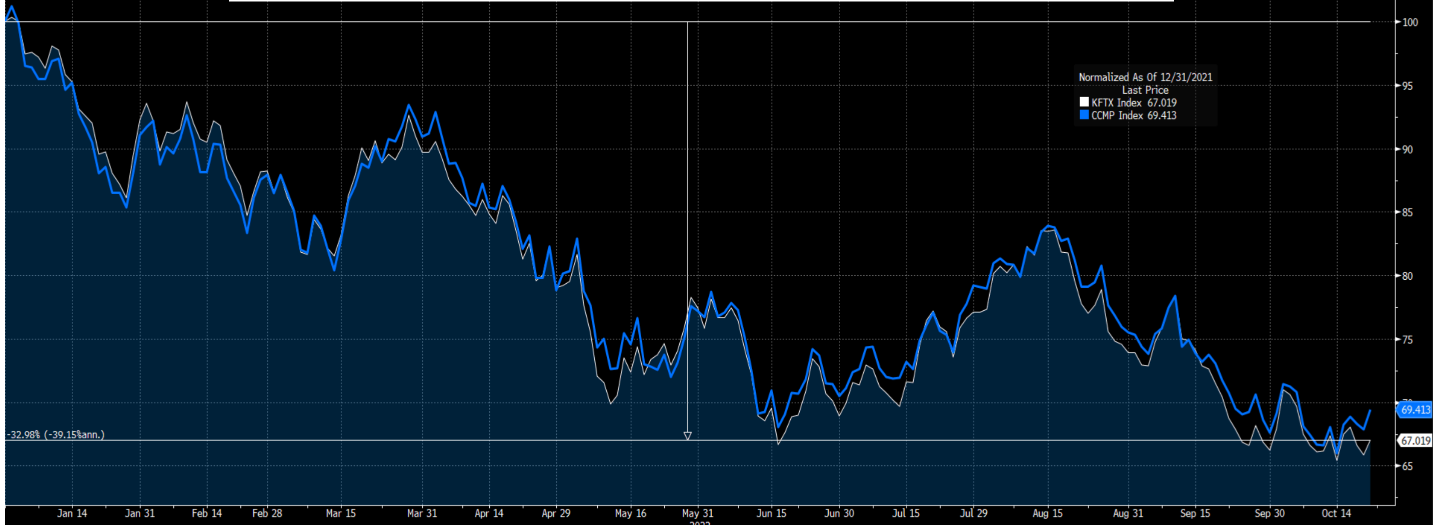
Typical success factors of FinTech solutions are:

- user scale (banks and other financial institutions already have a broad established customer base to market to while Start-ups can compete in product diversity by catering to specific consumer need)
- merchant reach (the number of vendors that accept payments through said apps)
- high engagement
- monetizable offerings (services that could potentially be monetized once a consumer base is amassed ex. Loans, Buy now Pay Later (BNPL)).

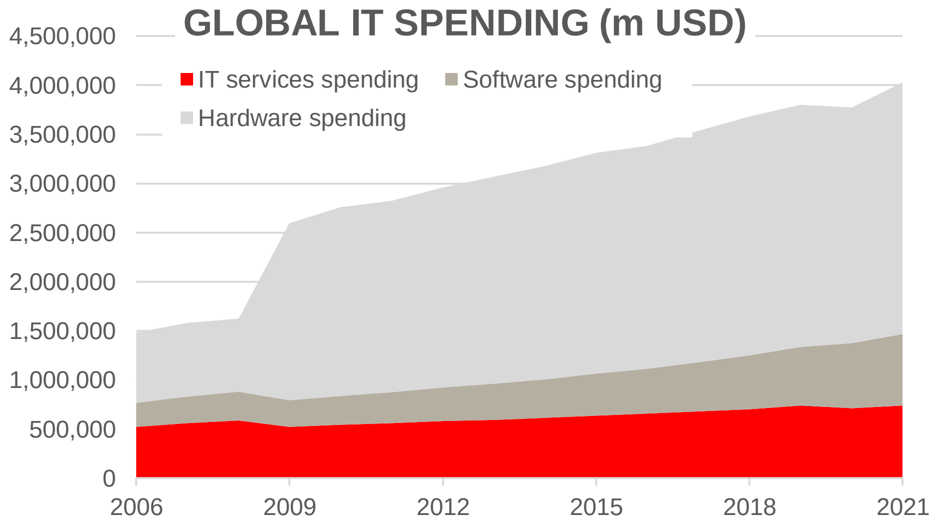
As for market trends, fintech stocks are moving close to the rest of tech stocks, with only a slight 2pp underperformance ytd in fintech stocks included in Nasdaq compared to the Nasdaq composite. Tech stocks were under bigger downside pressure in 2022 compared to general stock gauges (e.g. S&P 500 -21% ytd, vs Nasdaq -31% ytd), which is largely result of reversal of previous outperformance, with Nasdaq still outperforming S&P 500 by 17pp in last five years.

Since the fintech sector encompasses a massive reach of services and companies within the sector often have an entirely different business models, our analysis focuses on the regional market leaders. We have also not focused on the financial performance of legacy banks (despite their dominant market share in most of the Adria countries), as their FinTech business is embedded within multiple business and P&L lines.

NASDAQ Fintech vs. NASDAQ composite



Source: Bloomberg, Bloomberg Adria analysis



Source: Bloomberg, Bloomberg Adria analysis

Peer comparison

The region is characterized by widely varying adoption rates of fintech solutions and the prevalence of fintech initiatives. Our analysis focuses at regional leaders in fintech industry compared to benchmark players on a global scale in order to gauge the overall market direction for the local players going forward.

Aircash

Aircash started as a way of competing with Western Union and offering local and international P2P transactions, but in a process that was more simplified compared to legacy players. Nowadays, they are a digital wallet accompanied by a physical debit card, with options to purchase tickets for events such as concerts or sports, lottery tickets, prepaid vouchers, bus, ferry and catamaran tickets, parking payments, bill payments, and working on launching loans and QR code payments.

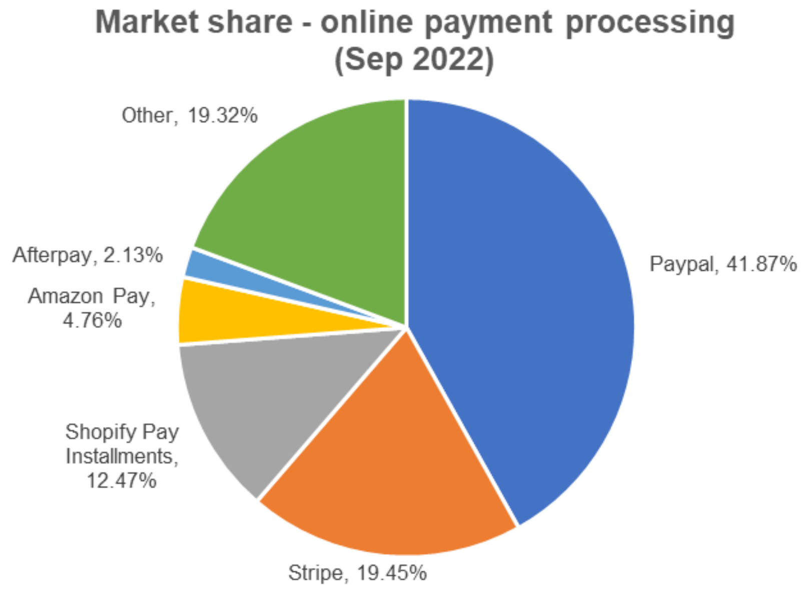
Launching their app with a simple service that solved an existing day-to-day problem allowed them to gain traction and start acquiring a large number of users by means of word-of-mouth. App owners understand that customer acquisition cost (CAC) is the single biggest expense in the product life cycle. In a world of gazillion apps, acquiring customers and letting them know that you offer one-of-a-kind solution to some of their problems is usually a “make it or break it“ point in many start-up journeys. Having a solution that users like in a way they are willing to talk about it and spread the word among friends and family gives the company an edge by keeping CAC low and consequently - company profitable.

Once the customer base is created, fintech companies introduce services which allows them to monetize the existing customer base and keep acquiring new customers. Customers are not the one paying commissions on these transactions, but rather merchants that are offering their products or services through the digital wallet app.

Relationship with merchants is the only barrier to entry for new market players. It takes time to put everything on paper and build trust. Once the merchant sings a contract, it is difficult for other market players to come and squeeze-out the existing ones. It takes time and better conditions are basically a prerequisite, which eliminates their bargaining power at the very start. Aircash app was launching around 2016-2018, after obtaining a regulatory approval by Croatian National Bank. The spotlight is on them due to their outstanding growth and remarkable financial results. Aircash generated sales of 680k EUR in 2019, and 12.1m EUR in 2021 – a staggering 1682% increase in sales. Meanwhile, they delivered 4.8m EUR in EBIT (39% margin) – a 50-fold increase from 71k EUR in 2019. That kind of growth, followed by profitability and positive cash-flow represents an exception, rather than the rule.

As for logical next steps in the business cycle development, once the customers create a bank account in the app's digital wallet and start consuming other forms of services, it is generally followed by introducing micro-loans services or BNPL services. It is a logical chain of events and brings to the app owner another form of monetization that creates a positive feedback loop in which every service offered benefits and supports the other. When customers spend on products or services – they need some extra money which is accessible via loans. At the same time, if customers have access to loans – they are more willing to make new purchases.

P2P payments typically remain without commissions, but to monetize the payments line of service, fintechs introduce payments in stores by way of scanning QR code. In that way, they completely circumvent the MasterCard's and Visa's payment processing system. In order to allure merchants to start accepting those kinds of payments, they offer lower transaction fees than Visa or MasterCard. Unlike physical payment world, competing in the e-commerce payment world would be more backbreaking for Aircash or any other market player due to dominant market shares of Paypal (fintech pioneer) and Stripe, coupled with consolidated e-commerce providers space being dominated by Amazon, Ebay, Alibaba and Shopify for small businesses. Becoming Amazon payment provider is certainly more difficult than becoming payment provider of a small neighbourhood caffe or restaurant.



Source: Statista, Bloomberg Adria analysis

Peer comparison - continued

The number of services for fintech firms such as Aircash would then be able to offer is unlimited, with the end-goal of creating a Super-app that offers solutions to everyday customers' needs. Services offered do not require a vast amount of capital investments, hence the remarkable ROE and ROIC numbers (115% in 2021) are supplemented by low CAC due to already existing customer base. More transactions bring more commissions and more word-of-mouth.

Services that are gradually introduced into the app need to cross certain hurdles defined by the company's management. Those hurdles normally include the following:

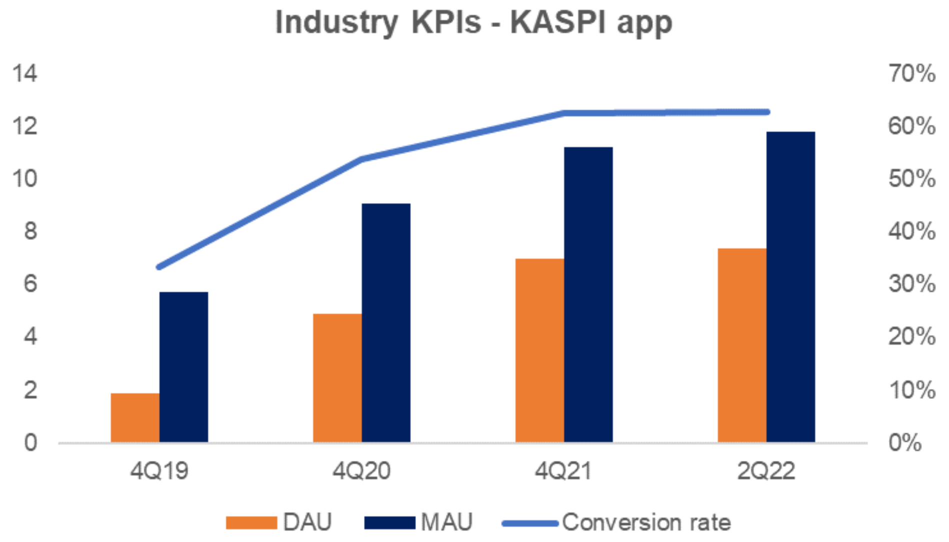
- Services that are consumed daily >> daily transactions result in better monthly active usage (MAU) to daily active usage (DAU) conversion i.e., more commission revenue. On top of that, if customers use the app daily, the chance of churn is reduced substantially and lower churn results in higher LTV (lifetime value)
- Services that are targeting a massive amount of people, desirably the whole market
- Services that solve a certain issue, whether in terms of convenience or cost
- Services that achieve satisfactory projected Internal rate of return (IRR).

Comparison to global peers - Kaspi

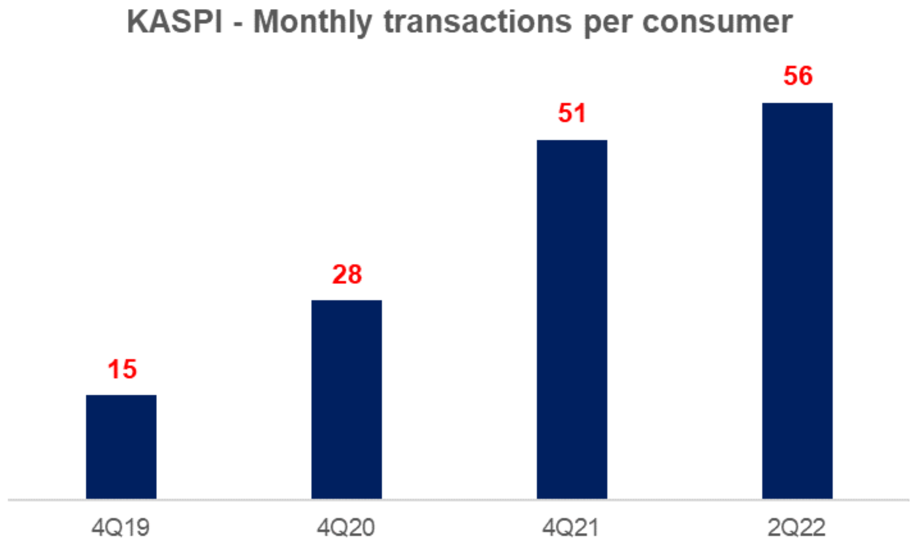
To showcase the full potential of the so-called Super-apps, we are observing experience of Kaspi – a London-listed company from Kazakhstan with a market valuation of approx. 12 billion EUR. To put that into context, Kazakhstan has a GDP of approx. 200 billion EUR, implying that the company's size is equivalent to approx. 6% of the economy's GDP.

Kaspi was a legacy bank that launched their e-wallet (internet wallet) and bill payments option back in 2012. That was followed by marketplace platform and online financing in 2014, debit card in 2015, mobile app and P2P transfers in 2017, QR code payments in 2018, mobile commerce and POS devices in 2019, airplane and train tickets in 2021 and many other forms of services.

Out of 19 million Kazakhs, their MAU (Monthly active users) is ~11.8 million (ca. 62% of population, a quite big share – for example, 71% of US citizens uses Facebook) and MAU to DAU conversion at ~63%, meaning that ~7.4 million Kazakhs use Kaspi on a daily basis. Average monthly number of transactions per user is nearing 60, which virtually implies that 7.4 million customers transact 2 times daily (on average) on Kaspi app. In 2017 company generated ~ 550m EUR in sales, while in 2022 they are on track to deliver ~2 billion EUR of sales, followed by an incredible EBIT margin of ~ 69%.



Source: IR Kaspi, Bloomberg Adria analysis



Source: IR Kaspi, Bloomberg Adria analysis

Peer comparison - continued

Since they've started as a legacy bank, fintech service such as consumer financing was always the most dominant line of service. However, share of consolidated net income attributed to fintech is decreasing on a yearly basis and as of this year, for the first time it will account for less than 50%, as a result of growing payments and marketplace services. Consequently, their EBIT margin is increasing constantly due to higher profitability of those two services. In addition to the sound results achieved so far, Kaspi keeps delivering high double-digit growth in both top and bottom-line, with ~40% and ~30% respectively.

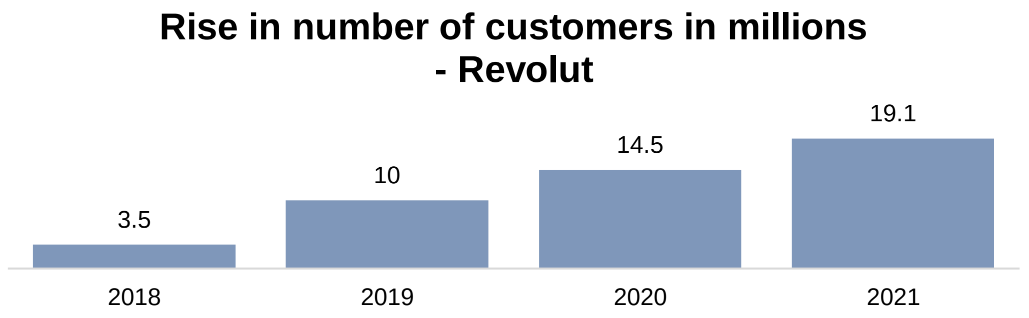
It is impossible not to notice the similarity of Aircash's business model to the one of Kaspi. Aircash has already penetrated countries such as Slovenia, Austria, Germany and Spain. They have ~500k users, 20m EUR monthly transactions, and are constantly launching new services, with the end goal of becoming a Super-app.

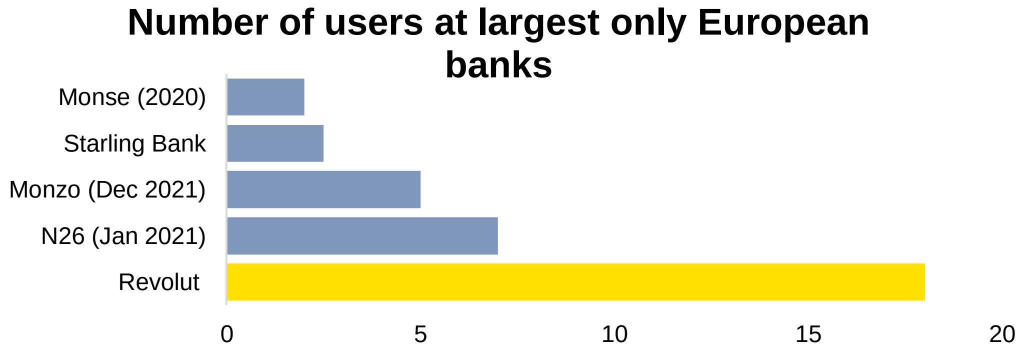
After starting as a fintech company, they made a rational decision of steering clear from traditional banking business (pure fintech) due to its strict regulation which limits business decisions, expansion, agility and ultimately growth. Nevertheless, with the already stable and sound business model, currently they are working on introducing loan services to further fuel the reach of their app.

Comparison to global peers - Revolut

Another stunning example is Revolut, a UK-based fintech company. Revolut started in 2015 as a travel prepaid card company offering cheap foreign-exchange fees and rounded up to be a digital bank. Today, it services over 20 million retail customers and 950 thousand business customers worldwide processing over 250 million transactions a month. Revolut was initially covering markets of EU and Europe region countries, currently rapidly expanding worldwide, building presence on the markets of Canada, Japan, Australia, etc. Operations in US were launched in 2020 while entrance to the India, Brazil and Mexico markets is ongoing. Revolut offers a wide spectrum of financial services in one place through a simple app. From peer-to-peer payments, ATM cash withdrawals, cross-border money transfers, travel and pet insurance, investment in stocks and shares, crypto trading, store purchases to money management tools. Having obtained a banking license in several countries across the EU (and still pending for UK) Revolut is on its path to become a large digital bank system rather than an instant money transfer application.

The Company is still experiencing rapid increase in the number of users and 3-digit growth of revenues, supported by a high product innovation rate. Revolut's users are now hardly willing to replace all services offered in one application with traditional bank service. Other recently





Source: AR Revolut, Statista

established neobanking companies (N26, Monzo) are recording sizable increase of users as well, speaking in favour of still unsaturated market and growing interest for digital banking services. In just two years, number of retail users went up for over 300% (from 3.5m/ 2018 to 14.5m/2020) and business users for over 900% (from 50k/2018 to over 500k/2020), which was followed by sharp revenue stream from ~66m EUR in 2018 to ~298m EUR in 2020. Gross margin improved as well from 25% in 2019 to 49% 2020 on the back of economy of scale and significant diversification of services.

According to the latest available financial data for 2020, Revolut still generates losses. In 2019 net loss amounted ~122m EUR while in 2020 it deepened to around ~296m EUR. Considering continued investment policy and spreading out the business worldwide, it seems that net profit will likely stay in negative zone for 2021 as well. Revolut has yet to translate this rapid growth into profitability. Therefore, valuation of Revolut at 33 billion EUR in a funding round performed last year by SoftBank and Tiger Global, remains questionable.

Peer comparison - continued

mBills

In Slovenia, fintech industry is dominated by Digital Payments segment, followed by Neobanking segment. Pure fintech companies are sharing the market with traditional banks which have done a lot to provide digital-friendly banking services integrating digital payments, microfinancing, etc. mBills is a mobile wallet company that has gone the farthest in digital payments services in Slovenia. Through mobile wallet, users can pay monthly bills, send money, pay online and at 1.500 points of sale in Slovenia, regardless of bank, operating system and mobile operator. For payments abroad, users have mBills Mastercard card that enables access to 44 million points of sale and which can be also connected to Garmin, Fitbit and Apple devices that support that payment. With a takeover by Petrol in 2017, users are offered to deposit or withdraw money at all Petrol stations as well.

Similar to other fintech start-ups, annual sales growth rates are high, but the company still didn't reach break-even point of profitability. mBills now counts more than 100k users but entrance in positive zone obviously requires higher number of consumers. Volume of scale is dominant success factor for increase of profitability but more secure is additional step into more diversified base of services. Activity is developing without external investors, dominantly relying on own sources and support of partners/ suppliers.

Centili

Locally-developed fintech services offered directly to local customers are quite rare in Serbia or B-H. Banking apps became widely used in the recent years, with an evident hike during the pandemic. Consumer habits lie heavily in favour of banking apps developed by legacy banks and/or traditional payment methods (card and cash). We perceive Centili Doo as a prominent fintech player in Serbia. Centili was formed in 2011 as a collaboration with Infobip, offering DCB services (Direct carrier Billing). In recent years Centili developed a B2B2C platform that is offered to telecoms, gaming companies, music companies and others. This is a white label monetization platform (PAS – platform as a solution) that utilizes Centili's network. Centili aspires to develop solutions that are marketed directly to consumers in the near future. Centili boasts growing top and bottom lines (232.5% sales growth in 2021 relative to 2020). Steadfast margins displayed amounting to 8.3% (EBITDA margin) in 2021 (rising by 3.3 pp relative to 2020) and 7.4% (EBIT margin) in 2021 (rising by 3.0 pp relative to 2020). Therefore, growth will be backed up by robust financial results achieved thus far.

In Serbia and BIH, we still do not see a market incumbent directly marketing to consumers except legacy banks through their respective digitalized offers. Therefore, the potential for adoption of a new initiative like Centili's, where a more agile and consumer centric approach is present. The presence of international players (for example Asseco SEE) also encourages the prospect of the uncharted market. Legacy banks are deeply rooted in the market ecosystem, and the entry of new incumbents will surely rock the boat in the long term. Banks will have to cooperate with players offering novel solutions. The key challenge in the aforementioned geographical markets is consumer education regarding the upsides of fintech solutions. Local regulations also stifle the scope and prospective implementation of solutions.

	Company name	Sales EUR in millions			Sales growth %			EBITDA margin %			EBIT margin %			ROE %			ROIC %			Net debt/EBITDA		
		2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021
Adria region	Aircash	0.7	3.6	12.1	242.3	436.1	232.5	14.0	31.9	39.9	10.5	30.7	39.2	12.0	93.1	115.1	11.1	91.9	114.5	(5.0)	(1.0)	(0.8)
	mBills	0.4	1.7	2.3	1880.7	373.2	34.4	(469.0)	(98.8)	(41.3)	(504.8)	(107.3)	(49.9)	(39.1)	(27.6)	(22.6)	(39.2)	(27.2)	(21.9)	n.a.	n.a.	n.a.
	Centili	1.0	1.7	2.1	n/a	62.8	26.6	(0.7)	5.0	8.3	(0.8)	4.5	7.4	205.8	391.4	117.4	206.3	311.7	110.0	4.0	0.0	(0.0)
Global peers	Kaspi	922.4	1068.0	1518.0	37.6	15.8	42.1	70.9	72.7	76.0	60.5	63.3	69.1	78.5	76.4	97.0	9.2	10.4	11.4	(0.2)	(0.4)	(0.2)
	Revolut	189.3	249.9	n.a.	187.7	32.0	n.a.	(63.5)	(88.7)	n.a.	(64.4)	(90.3)	n.a.	(73.6)	(80.3)	n.a.	(72.0)	(76.6)	n.a.	n.a.	n.a.	n.a.

Source: Company financial statements, Bloomberg Adria analysis

Outlook

The Adria region market is in its early stages of fintech adoption. We see potential for further adoption from both the legacy and start up market ends. Many large international fintech players (or players offering fintech related services) such as Paysend, Fis, HTEC, Asseco SEE have set up shops in the region.

Economic activity backdrop looks challenging for development of fintech industry going forward, notably with rising financing costs pushing investor demanded returns upwards. As for product mix provided by various fintech channels, we see investing into investment funds via fintech services under pressure from general risk aversion affecting investments in riskier assets in general. On the other, demand for payment services will remain structurally strong even if deteriorated economic activity could in some near times lead to less payment transactions as a function of general correlation between economic activity and transaction flows. That said, we see the economies continuing with declining use of cash to be increasingly replaced by mobile wallets and BNPL. FIS WorldPay projects that mobile wallets as a share of POS payments will grow to 14.7% in Europe by 2025, coming from 7.7% in 2021. E-commerce is also under change, with digital/mobile wallet payments therein forecast to account for 29% share in 2025 (vs. 27% in 2021).

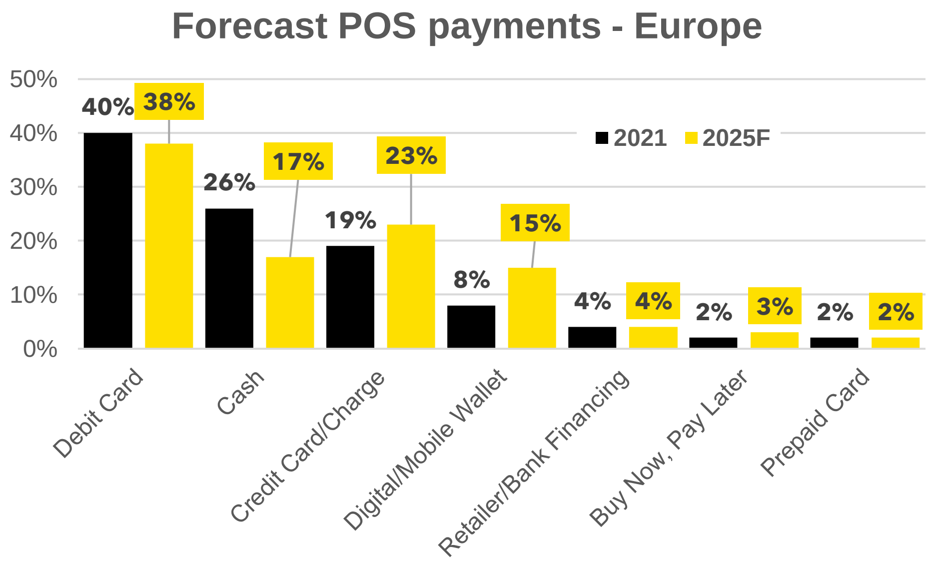
An accelerated growth in digital transactions will provide an upside in the fintech sector. Legacy processors will continue to find ways to better suit customers, leveraging their large consumer base, scale and market share. New initiatives will continue to compete based on diversity and flexibility, acquiring more customers. The main focus will be catering to the needs of the regional customers such as short-term loans in North Macedonia. In the past few years companies that offer „fast loans“ have emerged. Companies like mCash, Iute Credit, FlexCash are noteworthy. These services offer short term loans to consumers. Fintech companies rearrange according to the needs of regional customers. Loans can be streamlined and offered at a lower cost compared to traditional banks. This is especially prevalent due to rising costs of borrowing in the region. Aside from short-term lending providers, BNPL solutions are another direction we see regional fintech industry development like RokPay doo in Bosnia and Herzegovina.

Fintech solutions could also be source of alternative financing. By making financing accessible to a wider range of users (regardless of size or prevalence), adoption rates will rise, subverting users from legacy banks. These kinds of financing offerings are still in early days on the regional market in terms of adoption and legacy banks still handle around 90% of transactions.

The need to be independent from institutions and geographical location amid uncertainty will be the driver of innovation and subsequent adoption. Younger generations are in search for solutions that are not necessarily offered by traditional institutions. The need for innovation will drive legacy players to develop as well as give way for novel initiatives by start-ups.

Key competitive advantage against legacy banks is fintechs' agility and flexibility in answering to customer needs. Companies in the fintech industry are pioneers in the industry which was virtually non-existent a decade ago. In light of that, their competitive advantage is exposed and vulnerable to the creativity of European regulators and compliance requirements.

Aside from legacy banks, fintechs will need to compete with tech companies such as Google and Apple that have their own digital wallets, an established customer base, enormous capital backing, and above all - strong brands. Still, better understanding of local markets, ways of doing business and understanding customers' needs, coupled with early market penetration, gives local players an edge in competing against global forces.



Source: FIS WorldPay Global Payments Reports

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