Portage's
Fintech Outlook 2024

Portage

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Portage is a fintech and financial services investment platform. These are our focus areas for investment in 2024.

Fintech is not a homogeneous sector. With some exceptions, like AI or core infrastructure, the trends that shape opportunities in specific verticals can differ significantly. Wealthtech is not like Insurtech; Consumer Finance differs from SMB Finance.

Because of that reality, identifying opportunities for outsized returns requires deep knowledge of each vertical. At Portage, fintech is all we think about and all we invest in.

What follows is an overview of the trends and "investable themes" the Portage team is actively exploring this year. Our hope is that telling you where we're looking for our next portfolio company will, in turn, help you think about your own plans and strategies for 2024 and beyond.

As always, for those who want to take a deeper dive into any of the verticals below to help inform their internal plans and strategies, we love talking about fintech and are here to help our partners understand the implications and opportunities of how the space is evolving.

GenAI

***GenAI** was the biggest tech story of 2023 not only in the public markets, but also in venture capital.*

AI deals attracted more than US$40 billion in venture funding last year[1], and we expect the trend to continue through 2024. So far, the big tech incumbents, which largely own the foundational models and cloud infrastructure supporting GenAI, appear to have a data and distribution advantage in the space, but it is obviously early days.

US$**40**Bn
AI deals
in venture funding
in 2023

Use cases in fintech and financial services are still largely in the experimental phase. Yet, we take the view, that every company is now an AI company, and GenAI will increasingly be embedded in everything that Portage invests in.

We are particularly focused on solutions that have the potential to:

- Drive disruptive business models.
- Support incumbents in implementing AI in a compliant manner.
- Synthesize or copilot human advisors.
- Accelerate the transition from legacy to new tech.

Several of these areas of focus are touched upon in the following discussion of fintech verticals.

1. *State of AI 2023 Report*. CB Insights. February 1, 2024. www.cbinsights.com/research/report/ai-trends-2023

Consumer Finance

***Consumer finance** has seen a sharp pullback from the heyday of 2020-2021, accounting for only four of the Top ten deals last year (compared with eight of the Top ten in 2021).*[2]

Multiples in 2023 improved only slightly on already low 2022 levels. The pullback reflected a more general decline in consumer tech investing (it comprised only 7% of overall seed capital raised in 2023),[3] as well as the predominance of balance-sheet-intensive companies (especially insurance and banking/lending) in the space.

We are cautiously contrarian on consumer fintech in 2024, however. On a macro level, despite high household debt, consumer sentiment is strong across the U.S., Canada and Europe, inflation appears to have peaked, and unemployment is low. As well, two significant private-market deals (Monzo, Bilt) may signal a recovery in the space, and early data, albeit a small sample size, suggest a slight rebound in consumer multiples this year.

These factors support a case for highly selective investor interest, with a focus on companies that offer the potential for high growth metrics (>50% YOY), market leadership, robust margins and revenue diversification, as well as differentiated distribution models.

> Consumer finance accounted for only four of the Top ten deals last year (compared with eight of the Top ten in 2021)

2. Portage analysis of Pitchbook data. www.pitchbook.com/data
3. Dowd, Kevin. *Five charts showing how VC funding has shifted by sector*. Carta. December 19, 2023. carta.com/blog/vc-shifts-2023

Consumer Finance (cont.)

Among our investable themes in consumer finance, the shutdown of Mint in March of this year may create market opportunities in the **personal financial management (PFM)** space for companies like ***Albert***, a Portage portco. Multi-product companies continue to evolve, although in general the trend towards consolidation of fintech solutions into unified bundles has progressed more slowly than many expected. But GenAI's potential to bridge different data silos and synthesize information could accelerate the rebundling of solutions. We also think the macro consumer fundamentals, as previously mentioned, and a potentially more benign interest rate environment favour allocations to selective opportunities in lending; portfolio companies ***Achieve*** and ***Borrowell*** are examples of promising plays in this set.

Other consumer trends we are watching include **pay-by-bank** (including new merchant initiatives), and new **e-commerce and buying experiences** (for example, social commerce and text-based buying).

AI generates its own set of investable themes in the consumer space. Given regulatory constraints and the need for accuracy, it is no surprise that there have been few **consumer-facing fintech AI applications** to date, but the potential is there, particularly for AI and AI-powered "agents" to enable new customer experiences. Hyper-personalization, natural language interfaces, streamlined onboarding processes and simplified, consolidated customer journeys are areas we are focused on for capital deployment.

SMB Finance

The global economic footprint of small and medium-sized businesses (SMBs) continues to expand.

Since 2010, the number of small businesses globally has grown at 2.3% CAGR,[4] and last year SMBs accounted for 44% of U.S. GDP.[5] With the advent of vertical SaaS, gig work platforms and e-commerce enablement, it is our opinion that SMB growth is poised to continue. Those factors have driven a shift in the funding landscape: before 2021, B2B fintechs raised an average of $0.90 for every dollar raised by B2C fintechs; in 2023, B2B plays raised $1.90 for every B2C funding dollar.[6] We see further opportunities in the space through AI, which is increasingly embedded directly into SMB financial workflows to automate such tasks as cash flow, treasury and accounts receivable/payable management.

US$**1.90**

raised by B2B plays
for every B2C funding dollar
in 2023

4. Dyvik, Einar H. *Estimated number of small and medium sized enterprises (SMEs) worldwide from 2000 to 2021*. Statista. December 19, 2023. www.statista.com/statistics/1261592/global-smes
5. Agarwal et al. *Winning the SMB tech market in a challenging economy.* McKinsey. February 21, 2023. www.mckinsey.com/industries/technology-media-and-telecommunications/our-insights/winning-the-smb-tech-market-in-a-challenging-economy
6. Portage analysis of Pitchbook data.

SMB Finance (cont.)

In a higher rate environment, many SMBs are struggling to access credit, which supports one of our key investable themes for 2024: **differentiated credit**. We are seeing the emergence of innovative capital pools to provide end-to-end solutions such as software spend financing and B2B "buy now, pay later" (BNPL), which can support SMBs throughout the supply and value chains. Examples include Portage portfolio companies ***Oatfi***, a provider of end-to-end credit infrastructure for B2B payments, and ***Kontempo***, an embedded BNPL solution for B2B marketplaces, wholesalers and distributors in Mexico.

Embedded finance companies like Kontempo also represent another priority theme. Embedded solutions can reduce administrative burden for SMBs and help them think more efficiently about their financial needs in the context of workflow, while improving customer retention and expanding Annual Contract Value (ACV) and Average Revenue Per User (ARPU). Payments, loyalty, lending and insurance are growing categories of solutions being embedded in vertical SaaS platforms, like CRMs or accounting platforms. For example, our newest portfolio company ***Walnut Insurance*** offers insurance-as-a-service (IaaS), allowing any business to sell insurance products digitally via open API.

Our last investable theme is **e-commerce enablement**, which has helped drive SMB growth generally and we believe, is poised for expansion in the fintech-specific space. Focus areas include fraud prevention, returns and loyalty. Another growing enablement trend we're following is "re-commerce"; portfolio company ***Croissant***, for instance, provides an embedded resale platform targeting high-end apparel and premium consumer electronics.

Insurtech

A heightened focus on efficiency defines the landscape for ***insurance.***

Property and casualty (P&C) revenues have been constrained by slow GDP growth, tight financial conditions, high inflation and climate-related risks, as well as the transition to the IFRS-17 reporting regime.

Insurers are experimenting with digital-first business models to meet customer expectations for access, speed, customization and end-to-end service. This trend coincides with plummeting Insurtech valuations, which in 2023 fell to their lowest levels since 2017.[7] As a result, the current environment seems ripe for M&A, allowing incumbents to acquire digital capabilities or new business models to power their transformation.

We are focused on four investable themes in Insurtech, driven by the dual trends of efficiency and digital-first business models. The first is **claims management optimization** through AI and advanced analytics, which can help firms improve workflow management and process claims data more efficiently.

US$**40**Bn

Fraud cost in insurance industry

annually

The second, **fraud identification and mitigation**, addresses growing concern among insurers over ever-more sophisticated types of fraud, from AI-generated photos and voice replication to deepfake videos. Fraud already costs the insurance industry more than US$40 billion annually,[8] but digital solutions that enable faster and more accurate fraud identification and mitigation are rapidly maturing. Meanwhile, new regulatory pressures have created a need for better **underwriting and risk management** solutions which can help insurers better manage the evolving regulatory and policy environment.

Finally, we are focusing on Insurtech solutions for **distribution through digitally native applications**. Selling insurance to large, captive user bases is already a standard business model, but among the proliferation of embedded offerings there is opportunity for Insurtechs that solve for verticalized distribution to niche customer segments. Portage portfolio company ***Covertree***, a digital managing general agency (MGA) that provides insurance for residents of manufactured homes in the U.S., is a good example of an innovative solution serving a historically overlooked—but growing—niche market.

7. *State of Insurtech 2023 Report*. CB Insights. February 9, 2024. www.cbinsights.com/research/report/insurtech-trends-2023/
8. U.S. Federal Bureau of Investigation. *Insurance Fraud*. www.fbi.gov/stats-services/publications/insurance-fraud

Wealth & Asset Management

We believe two demographic megatrends are driving the evolution of the wealth and asset management (WAM) space.

One is the aging of the baby boomer generation, the youngest of whom turns 60 in 2024. This cohort's focus will increasingly shift from accumulating wealth to navigating retirement, transitioning to decumulation of assets and optimizing their estates. Those estates are substantial: boomers hold half of all personal net wealth in the U.S.,[9] making boomers a still-significant economic force—and one that is often overlooked by digital solution providers.

US$**68**Tn

Size of potential wealth of Millenials

The other megatrend is the so-called Great Wealth Transfer from baby boomers to Millennials, the oldest of whom are in their prime earning years. The transfer of wealth (estimated at US$68 trillion[10]) could make Millennials the richest generation ever. They have grown up in an environment defined by personalized digital experiences, and they expect the same from their financial service providers.

In this environment, WAM incumbents face twin challenges. On the one hand, they are grappling with fee compression[11] as new competitive threats emerge; reducing operating costs is a key goal. On the other hand, while financial institutions understand that new technologies can lead to better outcomes and margins, legacy tech infrastructure poses a barrier to innovation and a continuity risk in its own right. Without a migration to modern tech stacks, FIs may be unable to apply AI and other advanced tools to take full advantage of perhaps their most valuable asset: data.

9. U.S. Federal Reserve. *Distribution of Household Wealth in the US since 1989.* www.federalreserve.gov/releases/z1/dataviz/dfa/distribute/chart
10. Kelly, Jack. *The Great Wealth Transfer From Baby Boomers to Millennials Will Impact the Job Market and Economy.* Forbes, 9 August 2023. www.forbes.com/sites/jackkelly/2023/08/09/the-great-wealth-transfer-from-baby-boomers-to-millennials-will-impact-the-job-market-and-economy
11. *What is fee compression and how does it affect asset managers?* IG Prime. November 24, 2022. www.ig.com/en-ch/prime/insights/articles/fee-compression-asset-managers-220826

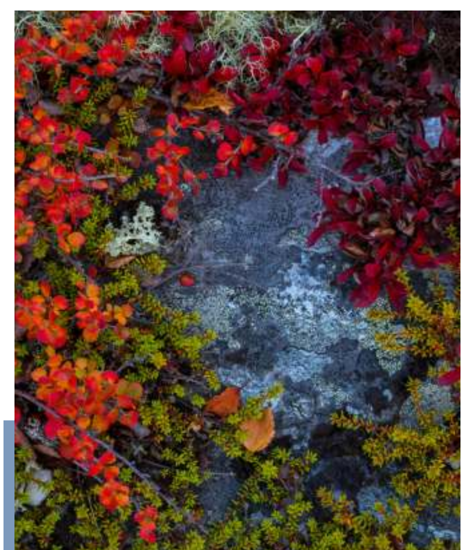
Wealth & Asset Management (cont.)

Investable themes in WAM reflect these emerging realities. Our focus is on **core infrastructure innovations**, particularly solutions that may replace legacy technologies and take advantage of the urgency to address the continuity risk of existing infrastructure. Areas of interest are wide-ranging, spanning **capital markets** (e.g., order management and clearing, alternative trading systems for equities and fixed income), **asset management** (e.g., transfer agencies, portfolio management systems) and **wealth management** (e.g., financial and estate planning, tax, compliance and client reporting). Portfolio companies in these spaces include ***Alpaca***, which provides end-to-end brokerage infrastructure for any company to add commission-free equities trading to their own products; ***Liquidly***, a platform that enables liquidity for illiquid assets; and ***Zilo***, a fund administration platform-as-a-service (PaaS) for transfer agents and their clients.

Payments

Payments is a very broad area with considerable geographic idiosyncrasies—the payments landscape in the U.S., for example, is very different from that in the UK, France or Canada.

Yet some general themes still apply. Most notably, the commoditization of functions is increasing across the payments value chain, which is putting pressure on margins and unit economics. This, we believe, sets the stage for consolidation across the industry; markets will reward scale and profitability, and customers will increasingly look to partners with multiple products to serve their expanding payments needs. As the ecosystem shifts toward a few incumbents, however, our view is that consolidation may open up opportunities for non-incumbent ventures to develop solutions that offer large payments platforms value-adds by increasing the stickiness of their core payments offerings and acting as a hook for additional growth.



One of our key investable themes is **verticalized payments** as a value-creation tool for SaaS providers. Capturing part of the payments spread through an embedded platform provides an opportunity to generate revenue and enhance the stickiness of the underlying software. This has been a promising area for some time, and identifying segments that are not served well by large incumbents will be key. One of those segments is gas stations, which have a very specific set of payments needs; ***P97***, a portfolio company, provides a cloud-based mobile commerce and digital marketing solution that connects fuel retailers to customers. We are also focusing on healthcare, where the implementation of SaaS-embedded payment platforms is still far behind other sectors.

Payments (cont.)

A sub-theme to verticalized payments is **embedded payments in the B2B space**. Because most B2B payments are still manual, there is plenty of room for digital innovation, and embedding payments into AP/AR automation tools and other financial software is a growing opportunity. Among our portfolio companies in this area is ***Notch***, an operating system for restaurant back-of-house that enables digitized procurement, invoicing and payments.

Finally, we note that the market penetration of **real-time rails** is progressing more slowly than expected in the U.S. Fraud is a continuing challenge, because banks do not have the risk and compliance infrastructure to support real-time payments implementation. Nevertheless, the adoption of ISO 20022, the new international standard for data interchange between financial institutions, could lead to new use cases for real-time rail and attract more solutions to the space over the long term.

+**280**%

Value of transactions using instant payments rails

through 2030[12]

12. Source - de Best, Raymond. "*Market size of real time payments worldwide in 2023, with forecast for 2030*". Statista. 1 August 2023

Regtech

In the wake of the Great Financial Crisis, financial institutions navigated more than a decade of regulatory proliferation and escalating costs of compliance.

That trend has accelerated in recent years, driven by bank failures, the rise of crypto, geopolitical and economic instability, and new technologies. Payments and other fintechs have also come under increased regulatory scrutiny. At the same time, however, budgets for compliance are under pressure, and skilled compliance professionals are in increasingly short supply. The field, therefore, appears wide open for modern solutions.

We see a significant opportunity for AI in this space as banks invest in solutions to make compliance more efficient and cost-effective. Examples include AI-assisted drafting of high-frequency regulatory reports and compliant customer communications; flagging suspicious customer or employee activity; building comprehensive customer risk profile and anticipating operational risk events. The near-term winners will offer FIs usable data, cost-efficiency and/or the ability to pursue higher-risk market opportunities. An allowance for effective human oversight will also be key.

Major concerns for regulators (and therefore banks) are **customer intelligence** and **anti-money laundering (AML)**. In 2023, AML fines in the crypto industry totaled US$5.8 billion,[13] and in recent years numerous banks have faced billion-dollar-plus AML fines as well. One of our portfolio companies in this space is ***ThetaRay***, which provides AI-powered AML transaction monitoring and screening solutions for fintechs, banks and regulatory around the world.

US$**5.8**Bn
AML fines
in crypto industry
in 2023

13. Noonan, Laura, and Smith, Adam. *Crypto and fintech groups fined $5.8bn in global crackdown on illicit money*. Financial Times. January 9, 2024. www.ft.com/content/f2a8c1e4-30f2-49c7-939b-73e0d1a22033

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