The Deal

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PRIVATE BRIEFING: FINTECH BOOM BRIDGES WALL STREET, SILICON VALLEY

From unicorn identity specialist Ping Identity to Members Exchange, financial technology continues to shine for both venture capital and private equity firms.

BY STEVE GELSI

While large IPOs from Uber Technologies Inc. (UBER) and Lyft Inc. (LYFT) have struggled in the public eye, Vista Equity Partners LLC-backed Ping Identity Holding Corp. (PING) debuted with much less fanfare on Sept. 20 at $15 a share and has traded well above $16 a share since then, with a market capitalization of $1.3 billion. While Denver-based Ping Identity works in many industries, it secures all of the 12 largest U.S. banks as measured by assets – putting it squarely into the realm of financial technology, or fintech.

Or take a look at Members Exchange LLC, or MEMX, which is launching a new public equities exchange in 2020 after receiving an initial investment from Bank of America Merrill Lynch, Charles Schwab, UBS, Virtu Financial and other financial players.

These are a couple of examples of financial technology deals that combine elements of Wall Street and Silicon Valley. While a disconnect between the West Coast and East Coast has arisen this year on the fair market valuation of money-losing unicorns, financial technology remains in favor.

"It's a hot area because there's been a number of people feeling for a while that the way financial institutions deliver products is too expensive and doesn't reflect the benefits of technology," said Kelly DePonte, managing director at Probitas Partners in San Francisco. "Fintech is trying to revolutionize how products get delivered. As this happens, some established players will have harder times. Fintech will totally change how financial products get delivered over the next 10 years. It's a macro trend."

Limited partners remain attracted to fintech-focused funds with more

narrow mandates, according to the 2019 Private Equity Institutional Investor Trends for 2019 survey by Probitas Partners. Seven percent of the survey respondents said they were focused on fintech-only funds, which rank among the most attractive in venture capital, according to the survey.

Tech-focused private equity, growth equity and venture capital firms continue to concentrate on the space including Vista, Thoma Bravo LLC, GTCR LLC, Francisco Partners Management LLC, Silver Lake LP, Accel-KKR LLC, FTV Capital, Lovell Minnick Partners LLC and many others.

Deals abound on a daily basis.

"The financial services industry is a bit broken in some respects," said Scott Joachim, a partner at Goodwin Procter LLP and co-chair of the firm's fintech practice based in Silicon Valley and New York City. "There's a lot of so-called tech debt – underinvestment in technology – that has built

up over the past 50 years or so in much of the technology infrastructure that underlies financial systems. Much of that infrastructure needs to be reinvented to a substantial degree. Every bank knows that. Every asset manager knows that. A lot of the fintech M&A and investment activity that's going on is really just part of a huge infrastructure project that needs to happen over the next several years."

Recent examples of fintech deals with Goodwin as legal adviser include the $260 million Series E fundraise by card services company Marqeta Inc. led by Coatue Management LLC and the sale of BlueTarp Financial Inc. to Capital One Financial Corp. (COF).

Early on in his career, Joachim began to notice a trend of private equity converging with a rapidly maturing technology sector, particularly in enterprise software. That convergence was replicated in a combination of financial services and technology.

"These two disparate worlds were colliding, but there were two very different perspectives coming together: Both East Coast and West Coast tech players have different deal terms, different cultural ways of approaching deal diplomacy and different ways to create compensation structures that align management and the broader employee base with the overall company, for example," Joachim said. "There seemed to be a missing adviser and interpreter role in bicoastal deals. As I did more work in this space, I realized there was a tremendous opportunity to build a specialty products practice around that convergence."

In general, New Yorkers and other East Coast dealmakers tend to be more direct and relatively conservative, while West Coast participants are often more willing trade upside for risk. Regardless, there's always room in every deal for fundamental humanism – to dig in and identify what's really on people's minds so that you can better devise win/win outcomes, Joachim said.

Compensation is a good example of where East Coast and West Coast investors and entrepreneurs sometimes start with different archetypes. East Coast firms are relatively more accustomed to dealing with more mature companies that can afford more cash-focused compensation, with less equity upside, while West Coast businesses tend to lure employees with incentive equity stakes that have more option value for growth in a venture-backed company, but with more downside risk.

Management teams at fintech companies from the East Coast tend to get recruited from larger PE firms, banks or other large institutions that traditionally reward employees with more cash and less equity compensation. On the West Coast, startups don't have as much cash to pay people, so they tend to lean more on equity stakes to compensate high-demand talent such as software engineers.

Blending deals from both coasts involves a bit of a balancing act between two cultures and two dealmaking approaches.

"You have to start with the business plan and figure out how all the pieces fit together: What's the profile of your management team? What are their expectations? What are you offering world-class engineers that Google, Amazon or dozens of other tech companies can offer? What are the governance expectations – how accountable is management to the board? You have to piece all of this together on a deal-by-deal basis," Joachim said.

Palo Alto, Calif.-based Symphony Communication Services LLC, which wrapped up a $165 million Series E venture round in June led by JPMorgan Chase & Co. (JPM), stands out as example of a deal that weaves West Coast and East Coast PE and VC mentalities around fintech, Joachim said.

It was founded by a Silicon Valley veteran, David Gurle, who worked at Microsoft Corp. (MSFT), Skype Technologies SA and Thomson Reuters Corp. (TRI). He came up with an idea for a communications platform that could displace email and chat, while satisfying the heightened security and regulatory obligations of regulated enterprises like financial services firms.

"He could have stayed on the West Coast and raised venture capital money ... but he made a very wise decision to partner with 15 banks including Goldman Sachs, JPMorgan, Citi, Bank of America, Morgan Stanley, Wells Fargo and several others," Joachim said. "A lot of the negotiations had to do with setting expectations on aligning incentives – to bring the sides together on compensation, liquidity expectations, governance, partnership. Goldman, the lead sponsor, and David ... came up with an agreement that a lot of people in Silicon Valley would say is too complicated, but it reflected a bespoke partnership that perfectly fits this particular deal."

Five years later, Symphony is a true unicorn, with a valuation of reportedly $1.4 billion in its last fundraising round.

Looking ahead, private equity firms that have proliferated in Silicon Valley as well as the Big Apple are expected to take aim at mature and emerging tech companies on both coasts, with a special eye on fintech.

"The market is maturing on the West Coast," Joachim said. "There are a lot more companies that have a profile that fits private equity. If you're a PE firm, you'll [seek out] businesses that are stable, sustainable and scalable. That's the three-legged stool for a PE investment."

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