

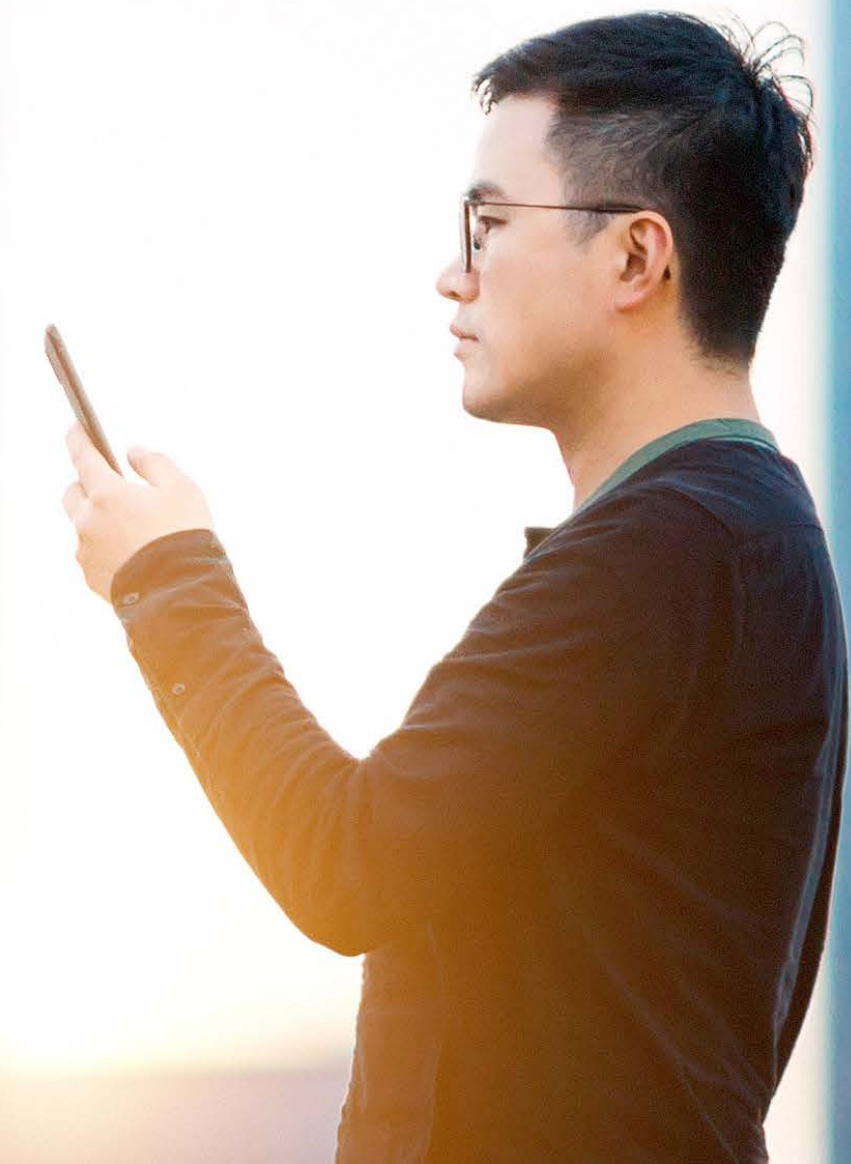
Freshfields **TQ**

Fintech in focus

Paytech M&A trends



Freshfields Bruckhaus Deringer



What to expect in payments deal-making

In this report we explain why the stage is set for an acquisition spree in 2021/2022.

We examine the payment trends that will drive M&A and share our insights on some of the latest regulatory, merger control and foreign direct investment developments.

01 Key drivers

The deal-making ‘frenzy’ of 2021

Key drivers of M&A activity include changing customer behaviour – with new fintech market participants entering the scene – further development of regulatory initiatives and new technologies enabling new business models.

Consumers and businesses alike have seen big changes in the ways we pay in recent years: cards, mobile payments and electronic wallets have become the new normal. The COVID-19 crisis, which encouraged reduced contact and online purchasing, accelerated this trend.

Developments in the payment space are also driven by technological advances, which enabled payments using mobile apps, increased security for consumers and various back office innovations to make it easier for businesses to make and manage payments.

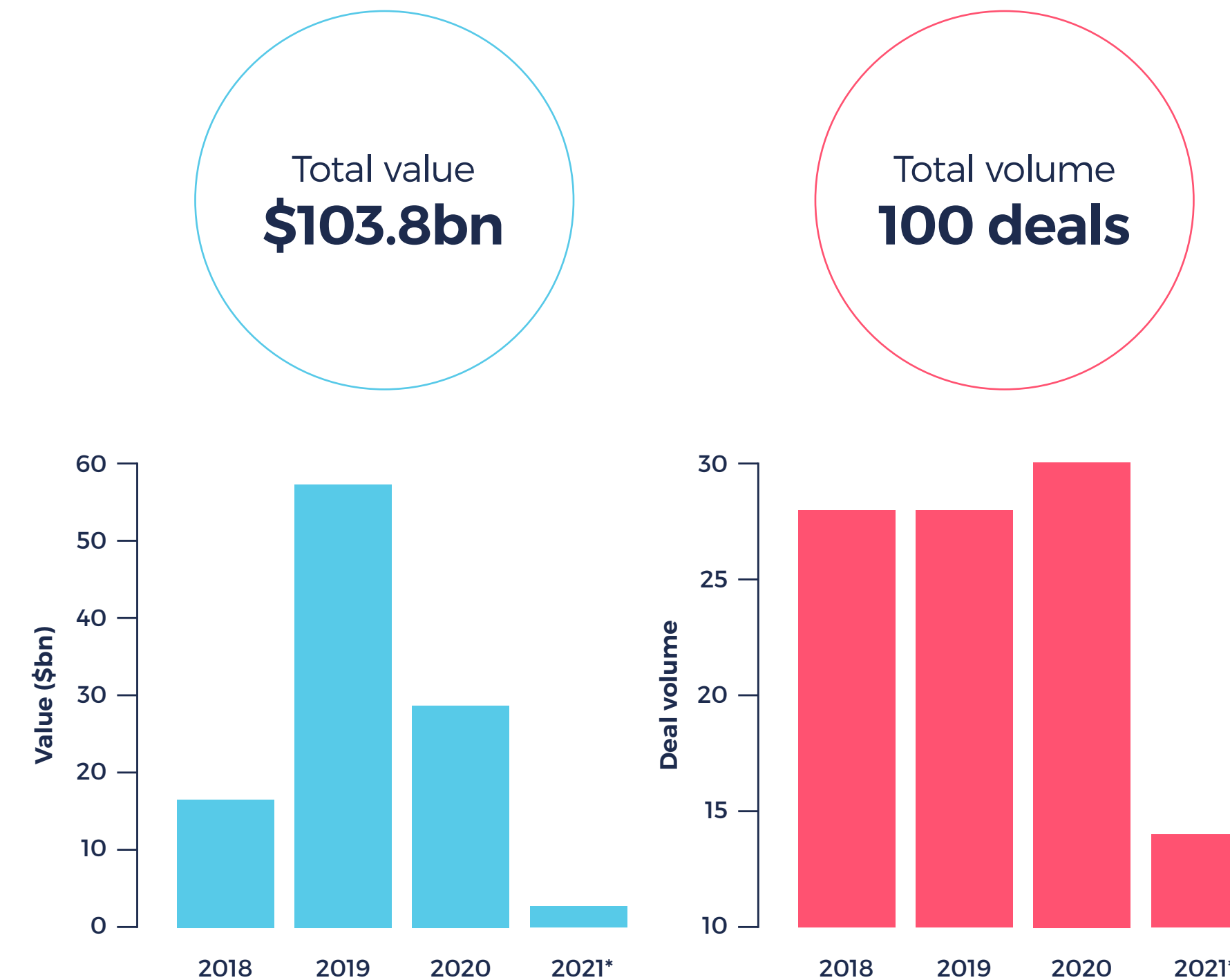
Deal activity in the payments sector remained robust in 2020. COVID-19 has accelerated the transition to a cash-light and e-commerce-heavy society so we see the structural tailwind for deal-making picking up speed over the coming year.

Both the value and the volume of global payment deals have grown in the past three years. The ongoing consolidation began about 20 years ago but the past three years have surpassed previous deal values.

Interest from financial sponsors has been one of the catalysts for this trend. Analysts expect this investment ‘frenzy’ will continue in 2021.

“**2020 and the beginning of 2021 was disruptive and chaotic. While it delayed or even changed the growth and financing plans of some companies, it also created great opportunities for new combinations that led to high deal volumes.**

Janina Heinz
Counsel, Regulatory



Source: CB Insights, Freshfields analysis
*Deals until 31 May 2021

02 Increasing value

Payment deals stand out in the global M&A landscape

Historically, there has been a lack of strategic payment fintechs (paytechs) reaching the size where acquisitions became part of their growth strategy. That has now changed.

Competition for assets in the payments space has been fierce in recent years with a vastly increased pool of potential acquirers.

Assets in the payments space are boosted not only by the booming e-commerce and financial services market, but also by the growing realisation that the data produced is increasingly becoming a core part of the digital value chain.

This is also one of the reasons why ‘big tech’ companies continue to show strong interest in this field and are increasingly looking to offer payment services themselves, either in co-operation with fintechs or through their own solutions. Payment data enables other service providers to truly understand customer behaviour and offer the right services to match demand.

Competition for assets in this area is therefore likely to increase further during 2021.



Source: CB Insights, Freshfields analysis
Deals from 1 January 2018 to 31 May 2021

03 Mega funding

High financing rounds could lead to 'mega IPOs' and 'mega deals' in 2021

2020 has set a new record for fintech financing. We have also seen numerous mega-rounds in the paytech market. Investors have demonstrated a continued interest in mature companies.

There seems to be little concern that, by the time these highly valued companies go public, growth will have slowed. Investors already started 2021 with big bets and we expect to see momentum, especially in the payments space, as there are some very promising unicorns to watch.

IPOs have been all the rage in 2020. As digital payments received a huge push amid the ongoing COVID-19 pandemic, investors are expected to bid equities up to further heights.



04 Payment trends

Evolving customer needs and disrupting technologies driving payment deals

We have observed six major payment trends that derive from evolving customer needs and a fast-moving development of technological opportunities.

At the macro level, 'digital' has redefined the consumer's relationship with payments, elevating payments from a basic operational necessity to a differentiator and a tool for businesses to better understand their customers. This has strengthened payments firms' ability and appetite to evolve and expand their offerings into new payments (and payments-adjacent) activities.

- **Banks reach an inflection point** – Challenges that propelled banks to spin off payment arms remain. Payments is a heavily commoditised market and may not be a strategic lever for some financial institutions with in-house payment capabilities. Those reeling from COVID-19 losses and lacking e-commerce expertise face a choice – they could either spin off payments as a 'non-core' business and increase RoE, or double down on payments, counter disintermediation and boost customer retention through 'open banking' and API integrations.
- **Platforms built on payments** – Seamless money flows, 'PaaS' and data analytics have become stand-alone value propositions for customers, as payments move from back office to front office. Merchants no longer see payments as a 'non-negotiable' essential; they are becoming increasingly aware of how to get more out of their payment solutions. The advent of technology-

first payment companies has made payment a critical customer experience factor. Pure-play legacy payment providers would continuously need to innovate or acquire new platforms and technologies to stay aligned with customer needs.

- **Small business is big business** – In-store and online merchant acquirers have benefited the most from the pandemic. The merchant acquiring firms have found increased relevance, offering innovative capabilities for merchants to handle payments, both offline and online. With tailwinds due to increased demand for payment services, merchant acquiring firms will continue their pursuit of merchant base diversification across verticals and regions. Some with strong portfolios of merchants in e-commerce and other attractive segments can look to diversify away from the acquirer-processing model and offer end-to-end solutions in a bid to build a more profitable client base.
- **Streamlining cross-border flows** – Cost of remittance is multiple times higher than a purely digital transaction. Traditional players have been under pressure from fintechs that can leverage blockchain and other emerging digital models to offer P2P options for transfers and remittances. Increasing financial inclusion through fintech bank-like services, particularly in emerging markets, could drive up adoption of digital remittance options, pushing traditional remittance vendors to innovate or strike partnerships.

- **Crypto and omnichannel payments** – Established leaders and new players are branching into crypto and crypto-related offerings to lure customers and allow merchants to maximise the potential of payment processing. Companies can leverage APIs/faster payments infrastructure to enable true interoperability and 'omnichannel' payments.
- **Rise of 'smart' alliances** – Recent all-time-high valuations might deter even cash-rich buyers. And while acquisitions may not always deliver the desired shareholder value, new alliances will continue to flourish as companies explore efficient ways to expand.



In the span of a few decades digital payments have gone from being niche to being part of everyday life. The future of money couldn't look more different today than it might have a year ago.

Matthew O'Callaghan
Head of Financial Services Asia, Regulatory

05 Case study Nets–Nexi

We are advising Nets, a leading payment service provider, and its majority owner, Hellman & Friedman, on the all-share merger of Nets into Nexi. The transaction is a transformational combination that will result in the creation of a European paytech leader and is valued at €7.8bn.

Nets is a leading pan-European paytech player, active in 20 countries and owned by a consortium of private equity firms made up of Hellman & Friedman, Advent International, Bain Capital and GIC. Over the past three years, since being taken private, Nets has undergone significant transformation and investment including through strategic M&A, such as the 2018 merger with Concardis and the sale of its corporate services account-to-account business to Mastercard for €2.85bn, which closed in March 2021.

Nexi is the leading paytech company in Italy and listed on the Italian stock exchange. Nexi has also announced a strategic combination between Nexi and SIA, an Italian and European leader in payment technology and infrastructure services. The combination of Nexi with Nets is a game changer in the European payments landscape creating one of the largest players in Europe with enhanced scale, client reach, distribution network and breadth of offering, which will further benefit from the SIA merger.

The transaction will allow the combined Nexi and Nets group to:

- create the largest pan-European payments platform;
- benefit from significant growth potential from exposure to European markets ranging from the fast-growing Italy to the structurally attractive Germany/DACH and Poland/CSEE region to the highly advanced Nordic markets;
- leverage a full portfolio of solutions across the payments ecosystem, with strong competences in acquiring and e-commerce; and
- be uniquely positioned to capture further organic and inorganic growth opportunities across Europe.

“
Nexi’s merger with Nets created Europe’s largest paytech firm by volume and is another example of national champions looking for cross-border growth through M&A.

Cyrus Pocha
Partner and Global Co-head of Fintech, Regulatory



06 Regulatory engagement

Regulatory developments are shaping the payments sector

Financial regulation has never been the driver of M&A activities. Time, resources and complexity are required to get deals over regulatory hurdles. In fact, regulation has actually increased in response to the rapidly growing fintech market and watchdogs exercise enhanced scrutiny over new business models.

However, in the wake of the revised PSD2, which aimed to foster innovation and increase competition between incumbent players and fintechs, new business models have emerged. The payments sector, in particular, has created a breeding ground for rising levels of M&A. Digital innovation is radically reshaping the provision of financial services. Payments, previously relegated to the back office, are becoming strategically relevant, especially in the retail sector.

The three areas below show how enhanced regulation has created new business opportunities:

- Following the implementation of 'open banking', banks have lost the exclusive access to payment data of their clients. Hundreds of non-bank entities have been authorised as payment initiation or account information services. An increasing number of banks themselves also now offer such services.

- At the same time, the introduction of strong customer authentication has become the norm when paying online, creating a new level of security of payment transactions. Payment service providers must ensure that their authentication solutions are compliant with the new requirements and provide users with a seamless and accessible experience to access their payment accounts and facilitate online payment transactions.
- The EU Commission has recently promoted the provision of instant payments as the 'new normal', offering EU payment service providers an additional opportunity to compete with global competitors. Through instant payments, funds are immediately available to payees and therefore are suitable for many uses beyond traditional means of payment, in particular in physical or online purchases, such as credit transfers, which are currently dominated by payment card schemes.

We anticipate that these developments will lead to increased deal activity, including the:

- emergence of large and globally active payment service providers;
- expansion of non-financial service providers' payments activities; and
- merger of payments and security providers.

In light of the development of new payment technologies, the enhanced need for the security of customer data and considering also the consolidation in the payments sector, which may trigger systemic risks, ensuring digital operational resilience and managing ICT risks will play a pivotal role and will continue to be in the focus of the supervisory authorities. In any case, increasing regulatory requirements should be taken into account at an early stage when working out an M&A strategy.

07 Global risks

Navigating heightened merger control and foreign investment review risks in payment deals

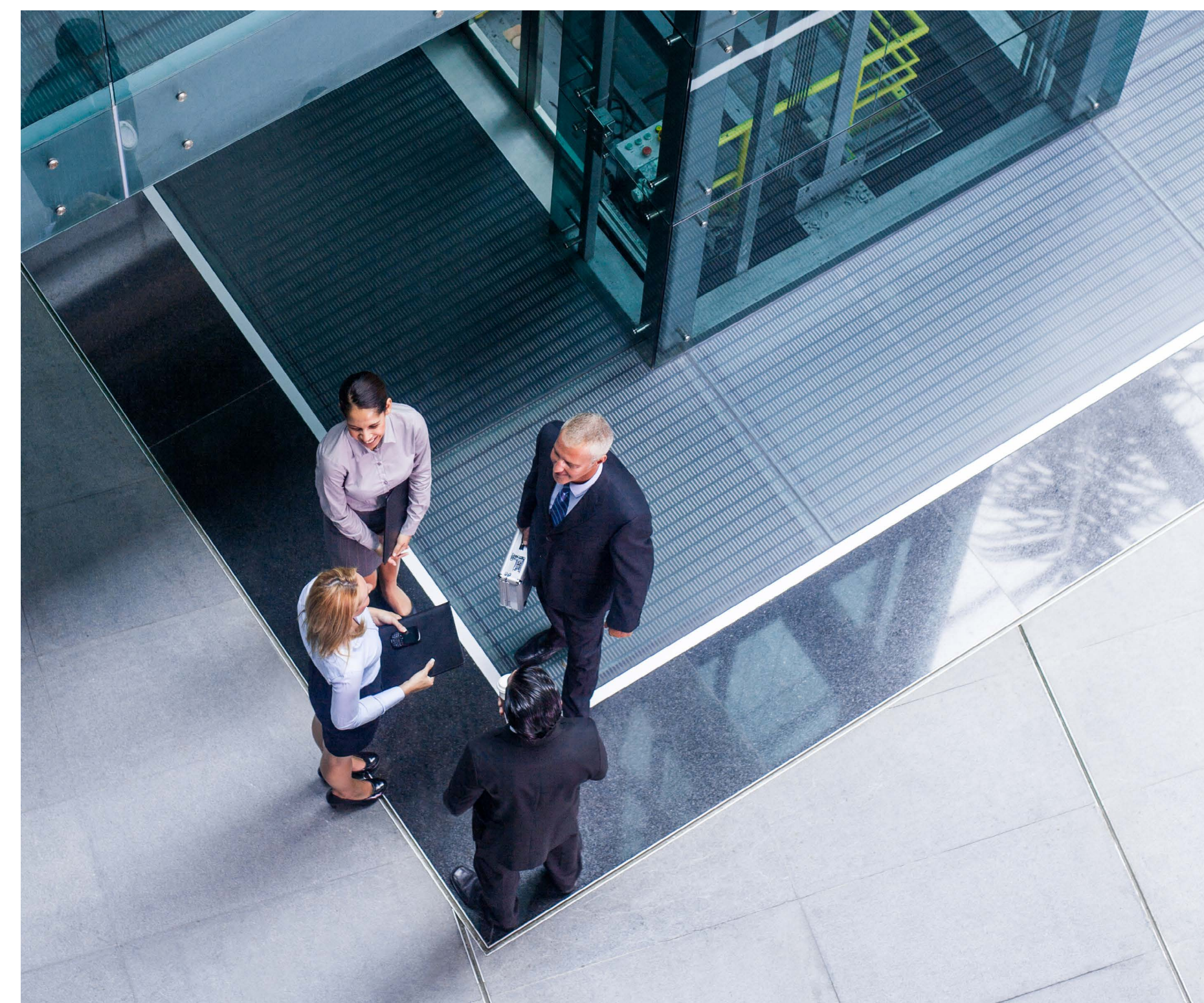
A range of different regulatory considerations come into play when doing deals in the payments space. Merger control and foreign investment reviews are two areas of growing importance.

Competition authorities are increasingly taking an interest in payment deals, and recent high-profile merger inquiries by authorities in the EU, UK and US indicate that a high degree of scrutiny of these deals is here to stay. Concerns have focused on so-called ‘killer acquisitions’ – the alleged practice by incumbent firms of buying up emerging or disruptive competitors to eliminate the threat of future competition, with the ultimate result of stifling innovation in the payments space. Competition authorities in some jurisdictions (eg in China, Europe and the US) are empowered to investigate these transactions even if they do not reach the mandatory notification thresholds. Separately, competition authorities are exploring novel theories of harm, including in relation to the data held by payments companies. If material competition concerns arise and remedies are required, merging parties may need to consider appropriate structural remedies (eg divestiture of data) and/or behavioural remedies (eg providing access to data or modifying algorithms) to secure approval. Against this backdrop it is more important than ever to develop a convincing, pro-competitive transaction rationale in order to get deals through.

Separately, the scope of foreign investment regimes continues to expand apace throughout Europe, Asia and the US, and many countries now routinely review deals in the payments sector because the companies in question hold sensitive data, develop technologies deemed ‘critical’ or play an important role as part of a country’s financial infrastructure. It is crucial to understand these sensitivities early in order to mitigate them if necessary (whether through transaction structuring or identifying suitable assurances/remedies). Careful and considered engagement with authorities is essential to avoid setbacks and guarantee a successful outcome.

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The key is being ready and knowing, to the extent possible, the nature and level of risk your organisation is expected to face within a transaction and having a robust scenario planning management in place.

Richard Bird
Partner, Corporate and M&A



08 Your key contacts

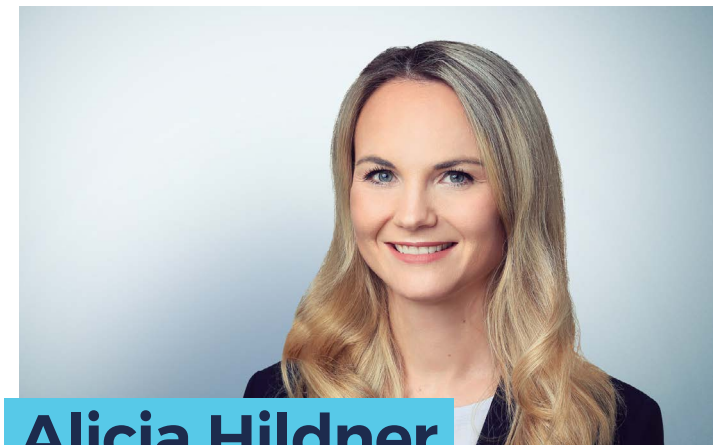
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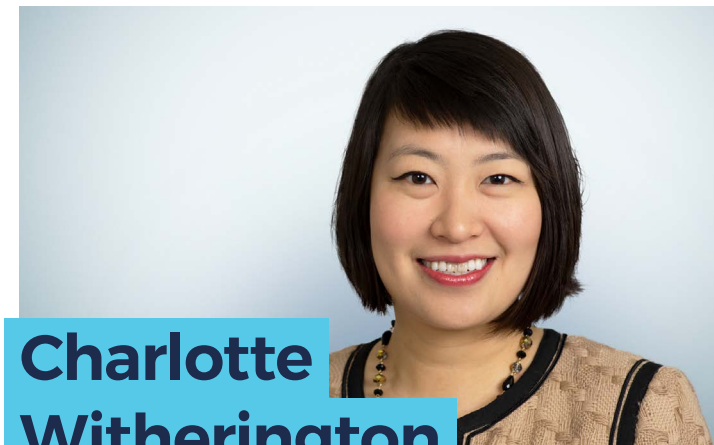
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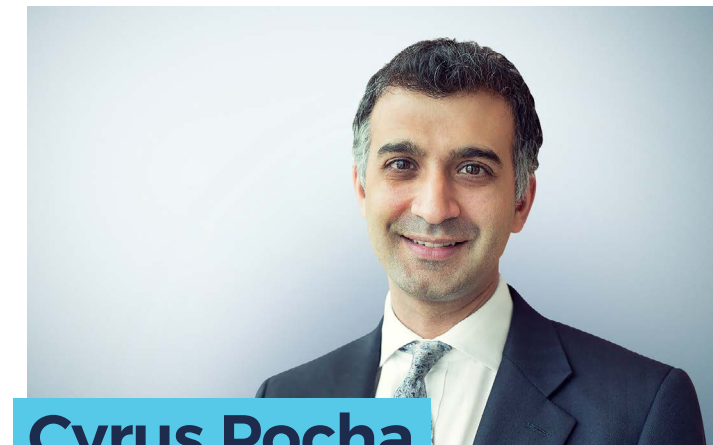
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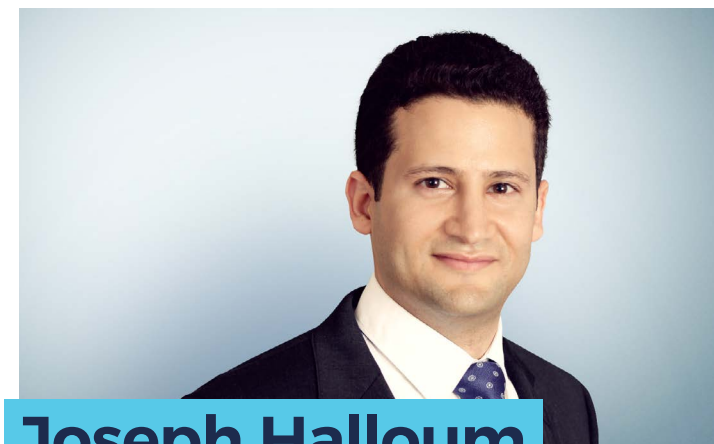
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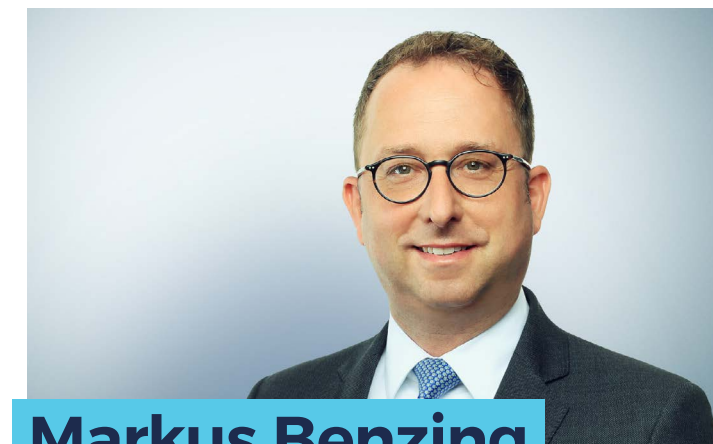
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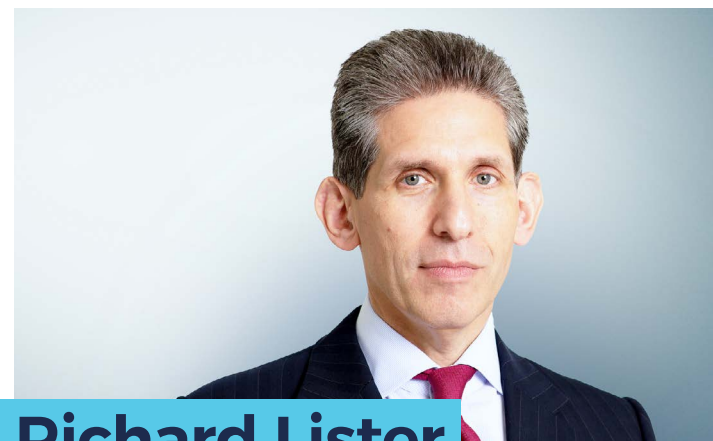
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