

INDUSTRY REPORT

Payments: Star Of The FinTech World

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EXECUTIVE SUMMARY

Unlike other growing industries, the payments industry hasn't experienced significant disruption and innovation. Large banks and credit card networks continue to dominate industry economics.

However, over the past decade, consumer and business expectations and preferences have rapidly evolved. Access applications and data have fundamentally changed. The rise of mobile commerce, particularly in developing nations, and the ubiquity of laptops, smartphones, and other connected devices has generated a surge in the ways consumers and enterprises can access the Internet and purchase goods or services. The relative market share of the traditional point-of-sale terminal in a brick-and-mortar store has been declining, and we expect those declines to accelerate as the market rapidly shifts towards digital payments.

In order to understand the future of payments, we must look at the industry as a whole – both through the lens of technology and of society. In this report, we've focused on seven key categories of questions that investors need to consider .

“Mobile devices, high-speed data communication, and online commerce are creating expectations that convenient, secure, real-time payment and banking capabilities should be available whenever and wherever they are needed.”

Jerome Powell
Federal Reserve Chair in March 2017

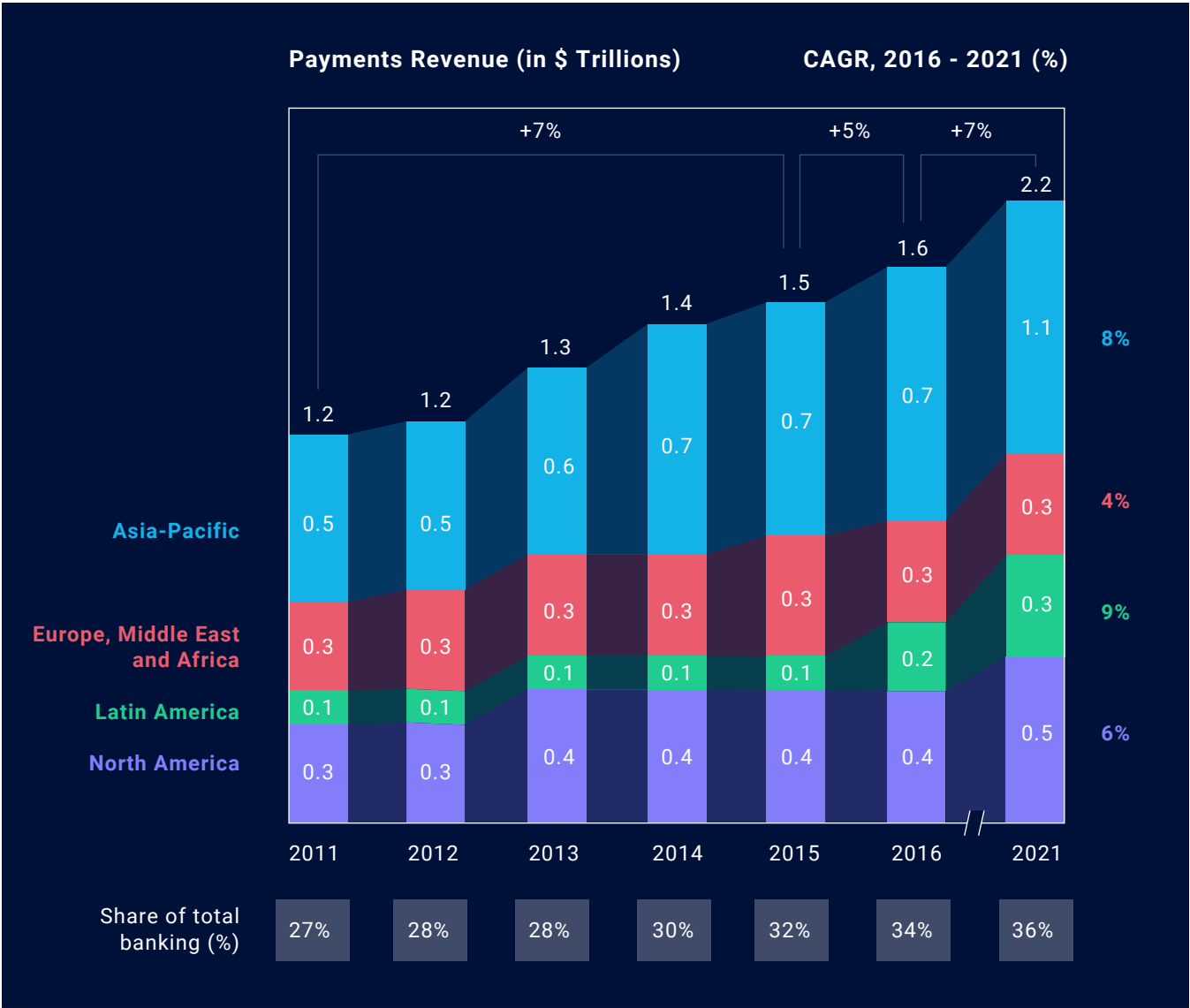
- **Brief Overview of Payments Industry**
What is the history of payments? What are the key categories in a payments flow and who are the key players?
- **Competition and Stakeholders**
Who are the industry stakeholders in the payments industry? What are their strengths and challenges and who are the key companies in each industry group?
- **Sizing up the \$110 trillion payments industry**
Can we accurately estimate the overall market potential for payments companies? Which segments of the the payments market are growing faster than overall global GDP growth?
- **Understanding unit economics of payments**
What happens to every dollar spent by a consumer before it reaches the merchant? How has the payments infrastructure evolved? Why are there so many payments companies today, and how do they serve the needs of companies?
- **Changing business models in the payment sector**
How are business models changing over time? What is driving some of these changes? Who are the winners and losers?
- **Current Technical Trends in payments**
What current technical trends are likely to shape the future of payments in the immediate and long term future? What are the underlying secular trends that continue to drive innovation in the industry?
- **Private investment trends in payments**
What is the state of investments in payments sector. Who are the top private payment companies and how much are they worth? Where are the largest payment companies located? How do investors feel about payment companies?
- **M&A and IPO trends among payment startups**
What are the latest mergers and acquisitions in the FinTech sector and how do they impact valuations?

GLOBAL PAYMENTS INDUSTRY OVERVIEW

In the ancient world, people traded goods and services under the barter system. People started to use paper money in Asia and Europe during the late 13th century. The 20th century saw the adoption of cashless payments, including checks, credit and debit cards, mostly in developed economies. In the 21st century, the Internet disrupted several industries, especially payments as fewer people used cash. Today, consumers pay bills, transfer funds, and purchase goods and services through smartphones. We believe cryptocurrencies and Blockchain will be the newest technologies to transform payments.

The \$1.75 trillion industry, which includes credit cards, account related liquidity, cross border transactions and domestic transactions for consumers and enterprises, will grow at annual rate of 7 percent over the next 3 years. Thanks to mobile devices, payments now make up 34 percent of overall banking compared to 27 percent in 2011. That number will grow to 36 percent by 2021, driven by growth in developing nations in Asia and Latin America.

Exhibit 1: Payments revenues to cross \$2 Trillion by end of 2021 [1]



The table below describes the categories and key companies that make up payments processing. We see companies increasingly expand into adjacent categories to preserve revenue share per payment. PayPal and Square, once exclusively payment processors, now provide point of sale and peer to peer services as well. Stripe and Adyen seamlessly handle payments from multiple platforms. Apple, Google and Samsung all provide simple cashless and cardless services for consumers at the point of sale, including some major retail chains.

Exhibit 2: Different categories within the payments flow and key players [\[2\]](#)

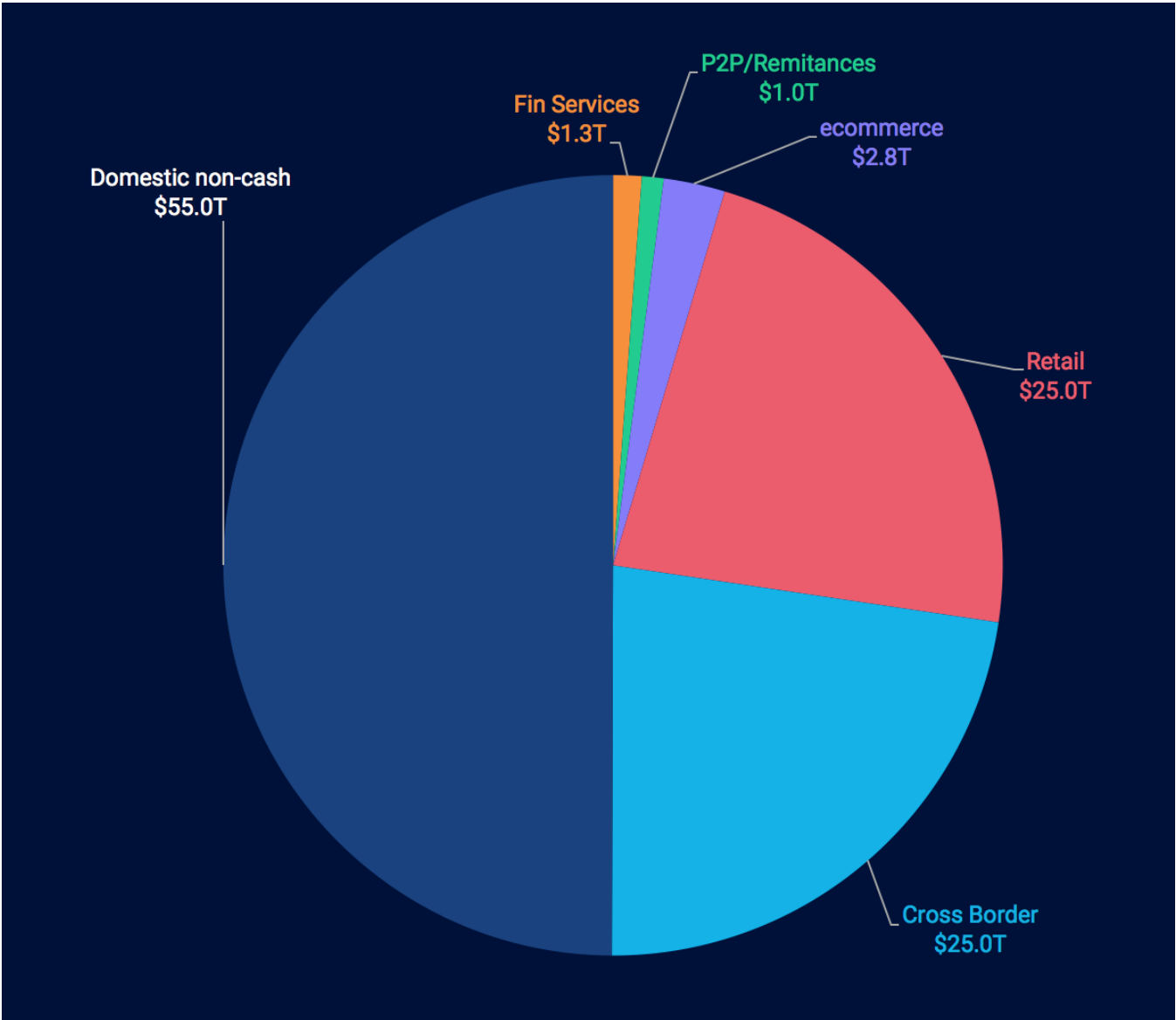
Category	Description	Popular companies in the category
Payment Gateways	Payment Gateways are used to transmit payments between the customer and merchant banks. They are primarily used for online ecommerce or physical cardless payments. The customer's card or payment details are transferred from the vendor's or ecommerce website to the payment processor which helps in validating and completing the transaction.	Apple Pay, Google Pay, Samsung Pay, PayPal, Square, First Data, Stripe, Adyen
Payment Processors	Payment processors are used to transmit payments between customer and merchant banks for brick and mortar stores. Payment processors typically also provide the processing equipment such as card readers reader machines to the vendors. Payment processors are broken down into two types: Front end and Back end. Front end interacts with the issuer bank and the credit card networks to validate the transactions while the back end handles the actual movement of the funds between customer and merchant banks	PayPal, Square, First Data, Vantiv, Payline, World Pay, Stripe, Adyen, Flagship Merchants
Credit Card Networks	Credit card networks such as MasterCard and Visa act as custodians and clearing houses for their respective card brand. They function as the governing body of a community of financial institutions, ISOs and MSPs that work together in association to support credit card processing and electronic payments. They govern the members of their associations, including interchange fees and qualification guidelines, act as the arbiter between issuing and acquiring banks, maintain and improve the card network and their brand	MasterCard, Visa, Discover, American Express
Card Issuers (Banks)	The issuers are the banks that issue credit cards to their customers. It is a part of the credit card association. The issuing bank verifies the customer's credit and account balance and then approves or declines a transaction. The bank charges a percentage of the payment to do this verification. The issuer bank fees is the largest across the entire payment processing chain	Bank of America, Citibank, Wells Fargo, JP Morgan Chase, Standard Chartered, Barclays

PAYMENT MARKET OPPORTUNITY

The global payments industry presents a market opportunity that exceeds \$100 trillion, including several services at least \$1 trillion in market size. Checks, credit cards and other forms of non-cash payments make up the largest share at \$55 trillion. The industry also covers a broad range of services, including account services from the big banks, cross border payments/remittances and peer to peer money transfer via messaging applications like WeChat and AliPay.

Big banks have long dominated the payments industry. However, technology companies are now disrupting their business models. At first, PayPal, Vantiv and First Data focused on processing between financial institutions and vendors. Then Square and iZettle expanded into the direct relationship between businesses and consumers, including point of sale and peer to peer transactions. With the emergence of mobile devices, Stripe and Adyen created whole new infrastructures to manage multiple payments along the chain, including point of sale, online, peer to peer and app-based transactions. These companies can also help businesses identify customers who use all these methods.

Exhibit 3: Payments is a \$110 Trillion opportunity [3]

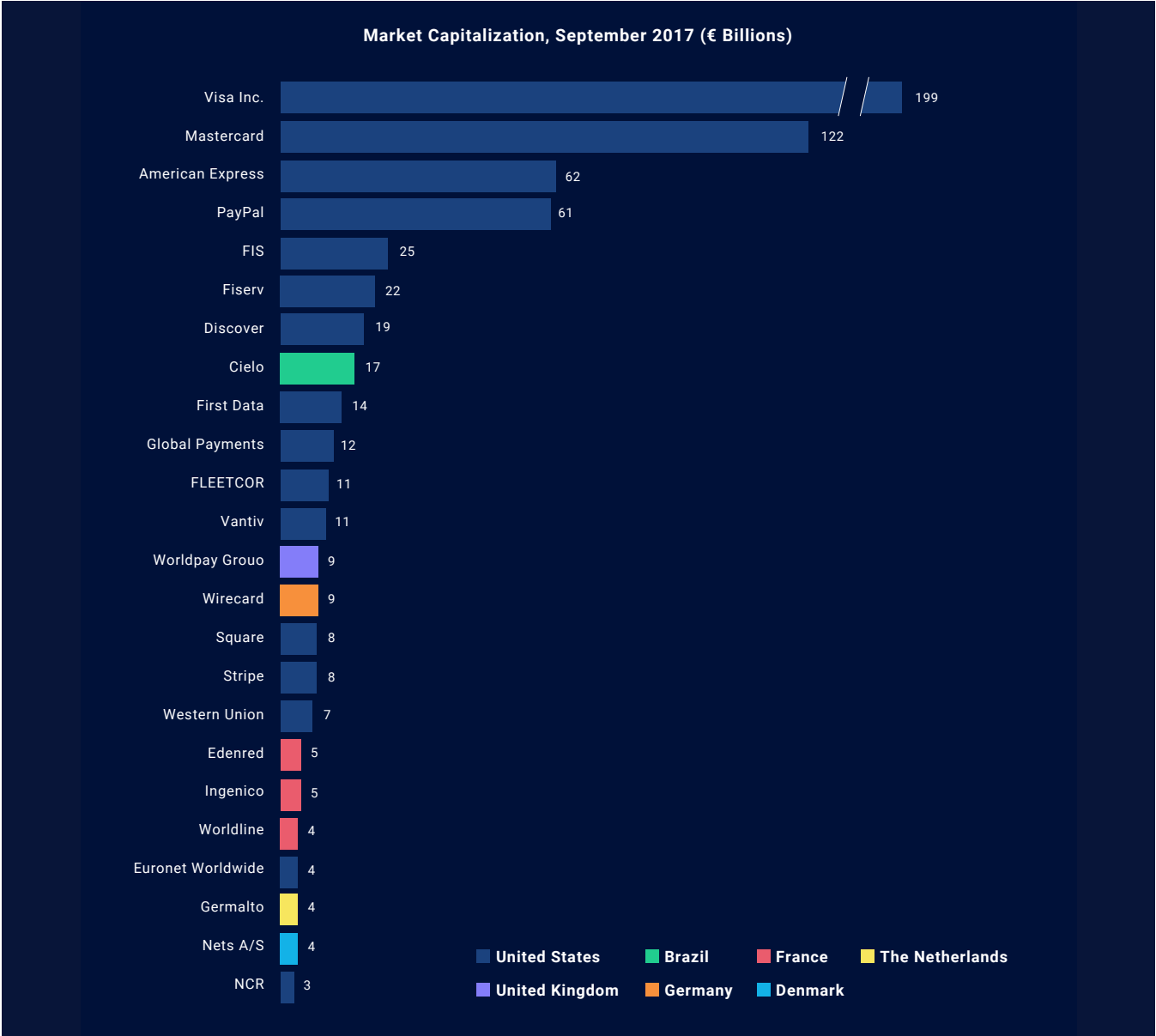


COMPETITORS AND INDUSTRY STAKEHOLDERS

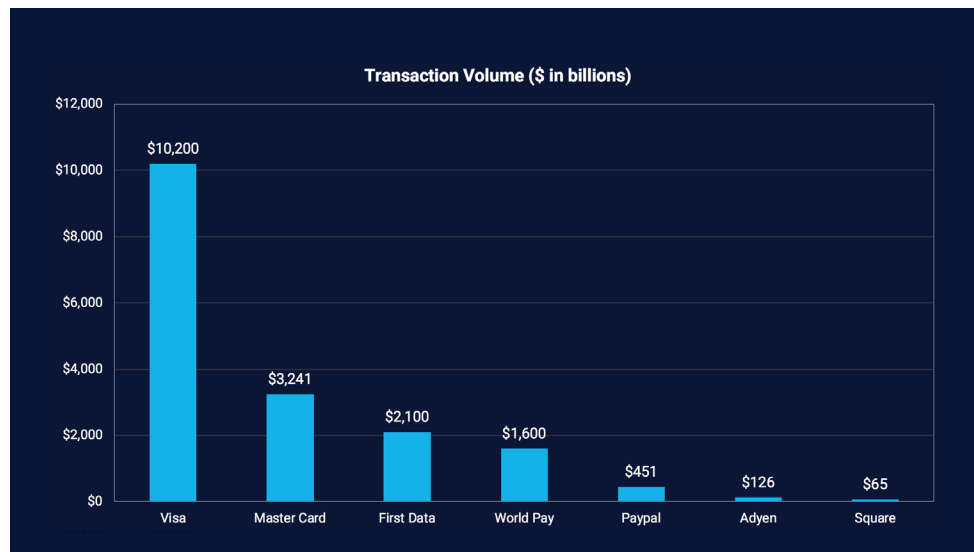
The payments industry is full of large and small competitors: big banks who primarily offer savings and checking accounts to Blockchain startups with smart contracts. Citi, JP Morgan Chase and Bank of America operate in the accounts-related liquidity subsector while Master Card and Visa dominate credit cards. Western Union, Xoom, MoneyGram, Transferwise and Remitly control the \$300 billion remittances market.

Judging by market capitalization, U.S. companies like Visa, MasterCard, and American Express dominate the overall payments industry, followed by financial technology platform companies, peer to peer payments and cross border payment firms.

Exhibit 4: Visa and MasterCard are the top non-bank payment companies in the world [4]



Visa and Mastercard control 75 percent of total transactional volumes. First Data and World Pay focus on processing card-based transactions. PayPal and Square have quickly adapted to changing consumer behavior and developed API integration options for vendors to start and manage businesses.

Exhibit 5: Visa dominates the market with maximum transaction volume [5]**Industry stakeholders in the payments industry**

Below is an overview of the payments industry as a whole and its key stakeholders. Each stakeholder offers some benefits but also faces challenges. Using smart contracts and distributed ledger technology, Blockchain could solve these problems.

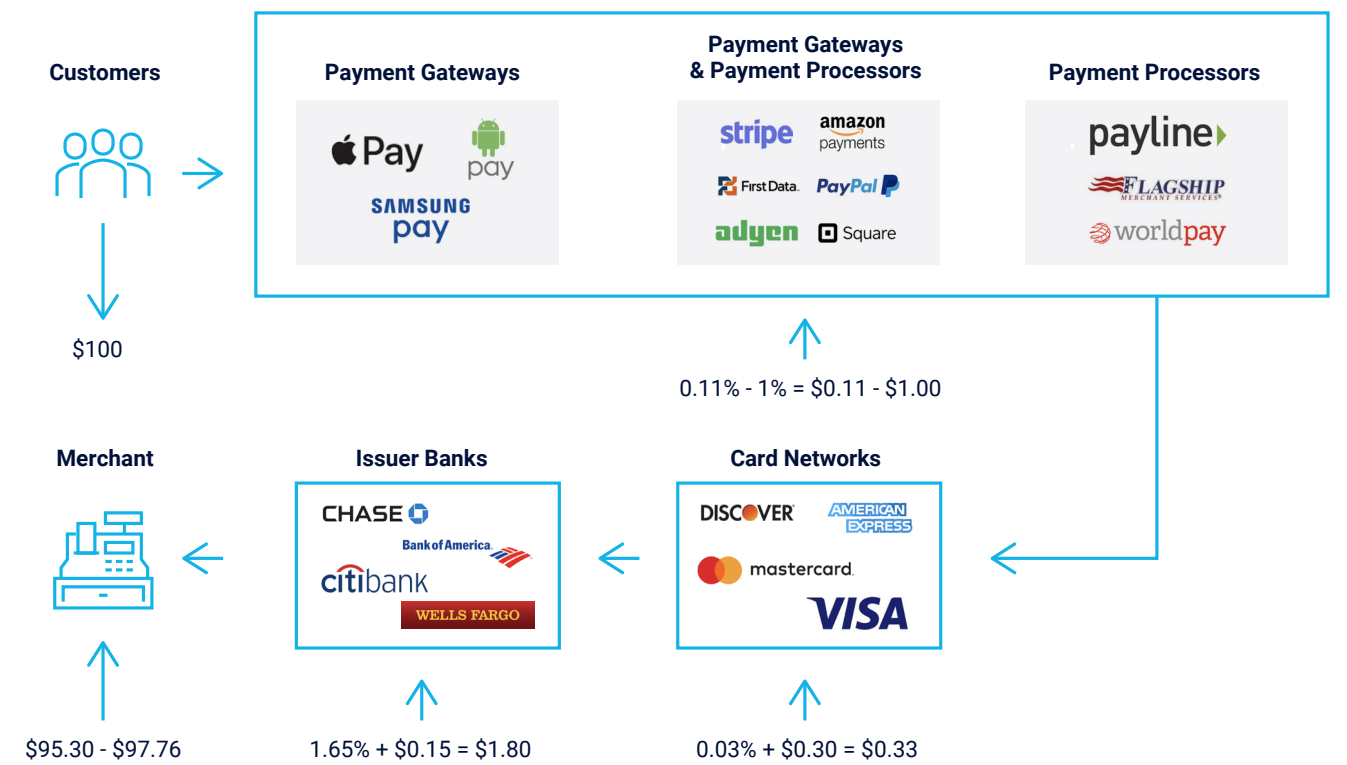
Exhibit 6: Payments Industry Overview [6]

Category	Key Players	Positives	Challenges
Big Banks	JP Morgan Chase, Citi, Bank of America, Wells Fargo	1) Global Reach 2) Handle consumer and business accounts 3) Government regulated and FDIC protected. Recently launched Zelle, a digital payments service to compete with big tech and peer to peer service providers	1) Need nostro, vostro accounts for international payments 2) Takes days to complete crossborder transactions 3) High transaction costs
Big Tech	Apple Pay, Google Wallet, Alipay	1) Convenient transactions using smartphones 2) Supported by well trusted consumer brands 3) No fees to consumers for using these payment options	1) Only supported by select businesses 2) Businesses charged a percentage by the tech company 3) Businesses need infrastructure upgrade to support these services
Peer to Peer Payments	Square Cash, Venmo (Paypal)	1) Quick & convenient purchases and peer to peer payments 2) No processing fees 3) Smartphone growth propelled usage	1) Primarily used only for domestic transactions 2) Compensation from competing apps, banks and messaging platforms 3) Challenges with integrating with bank accounts 4) Both the transacting parties will need to have the application to transact
Payment Processing	Stripe, Paypal, Due, Square	1) Minimal set up fee 2) No monthly fee 3) Easy to set up	1) Security challenges 2) Transaction costs 3) Integrating with existing business applications
Crossborder Remittance	"Western Union, Xoom, MoneyGram"	1) Safe and trusted means of transfer 2) Global network 3) Dominant mode of remittance	1) High transaction fees 2) Long processing times 3) Not available in all countries
Credit Cards	Mastercard, Visa	1) Global trusted network 2) Convenient cashless purchasing-online and offline 3) Get analytics on spending patterns 4) Fraud detection	1) Availability dependent on credit score 2) Foreign transaction fees 3) Business need to pay a % per transaction 4) Personal transaction data sold to 3rd parties
Disruptors: Blockchain Companies	Ripple, Circle	1) Very low transaction fees 2) Quick and convenient means of payments, domestic and international 3) Accessible across all countries 4) No need for nostro, vostro accounts	1) Very new and unfamiliar technology 2) Needs infrastructure upgrades 3) Volatile: co-related to cryptocurrencies

HOW DO PAYMENTS COMPANIES MAKE MONEY

The payments ecosystem covers the point of sale at the buyer (customer) to the seller (merchant). The payment gateway (Apple Pay, Samsung Pay) encrypts the payments and sends them to the payments processor, which transmits data to the customer's issuer bank to confirm credit/debit card transactions. To boost efficiency, companies like PayPal, Square, and Amazon act as both the gateway and processor. Once the bank approves the payment, the processor transfers the amount into the seller's account. These companies charge fees, which eats into the seller's revenue.

Exhibit 7: About \$2.24 for every \$100 transaction goes towards payment fees [7]



The chart above demonstrates the flow of a typical payments cycle. Companies typically charge fees roughly equal to 2.9 percent of the total price plus a \$0.30 per transaction. So for a \$100 purchase, the merchant collects \$97.76. The issue bank gets \$1.80; the payment processor and card companies receive \$0.33 and \$0.11 respectively. There are also set-up, refund, and cancellation charges.

TRANSITIONING BUSINESS MODELS IN THE PAYMENTS SPACE

Past

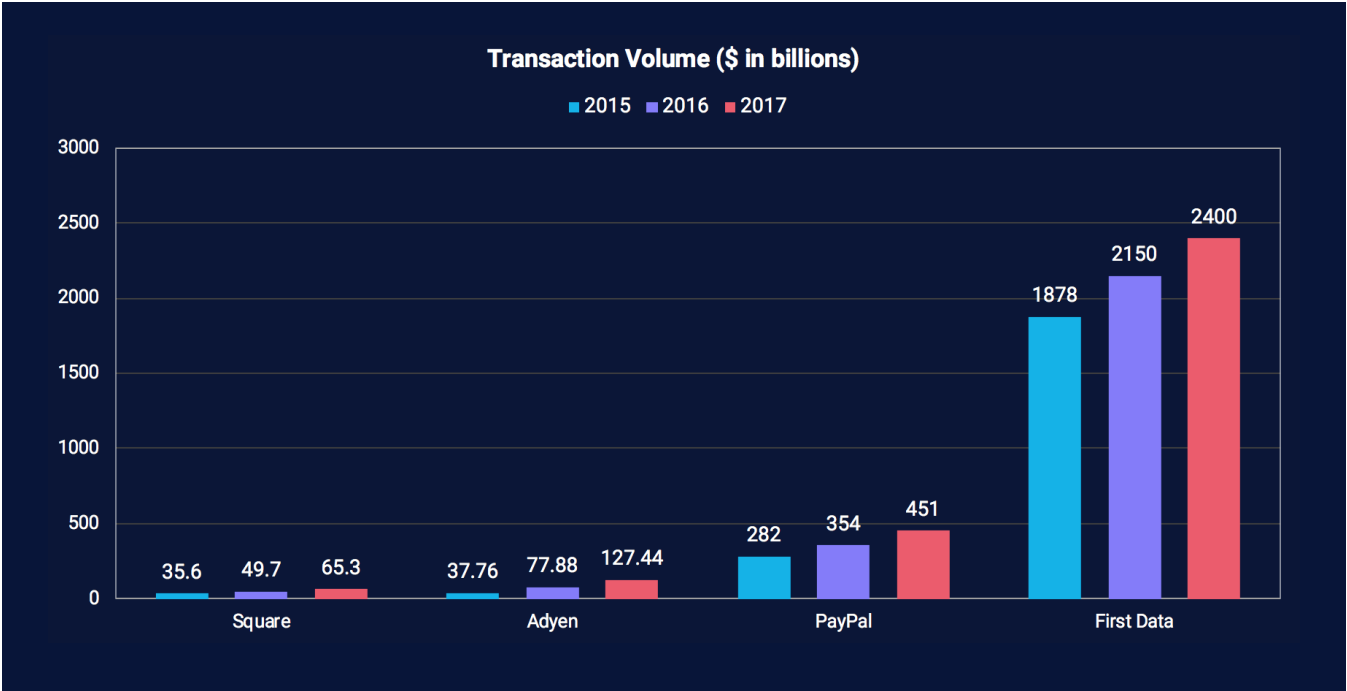
Prior to the Internet, banks exclusively provided payment services to consumers and businesses. With the emergence of credit and debit cards, banks had to share revenue with credit card companies and payment processors. As tech firms entered the market, banks and processors extended services to peer to peer payments, gateway validation and point of sale infrastructure to grow their customer base.

Present:

Companies are transforming the payments infrastructure into a network that provides a seamless experience to consumers no matter the payment option they prefer. As consumers rely more on mobile devices, they are using much less cash. Consumers can now store money on platforms such as messaging and e-commerce, eliminating banks from transactions all together.

The chart below compares the transaction volume of incumbents vs. newer companies. As expected, First Data and PayPal have significantly higher volumes. But Adyen and Square are rapidly catching up by building partnerships with large tech companies.

Exhibit 8: Transaction Volumes for incumbent payment vendors exponentially higher [8]



The take rates (revenues as a percentage of transactional volume) shown below for these companies shows the stark difference in their business models. Credit card companies such as Visa, which has the largest transactional volume, have the least take rate compared to the other processing companies. This is because the validation and processing is done by other players in the payments chain. Square, which uses a tiered pricing model has a higher take rate compared to PayPal which has a flat rate of 2.9% plus a flat \$0.30. Adyen, on the other hand, has just 1% take rate although it is similar to PayPal and Square in terms of the number of processing steps it takes care of along the payments chain. A lower take rate in addition to its ability to integrate payments from multiple sources makes it popular amongst companies that have large daily transactional volumes such as Uber, Netflix and Spotify to name a few.

Exhibit 9: Take rates range from 0.2% to 3.4% across payment vendors [9]



Future:

Blockchain could upend several industries, especially payments. Using the distributed ledger framework, the technology is already disrupting cost models for currency transactions. Crossborder payments and remittances are getting significantly cheaper and faster with less paper work and middle men. Transactions could be completed in minutes rather than days and weeks. Amid a developing legal and regulatory environment, companies like Ripple and Circle have partnered with several banks and corporations to pilot this technology across the globe. To learn more about Blockchain and its applications, please check out our report [here](#).

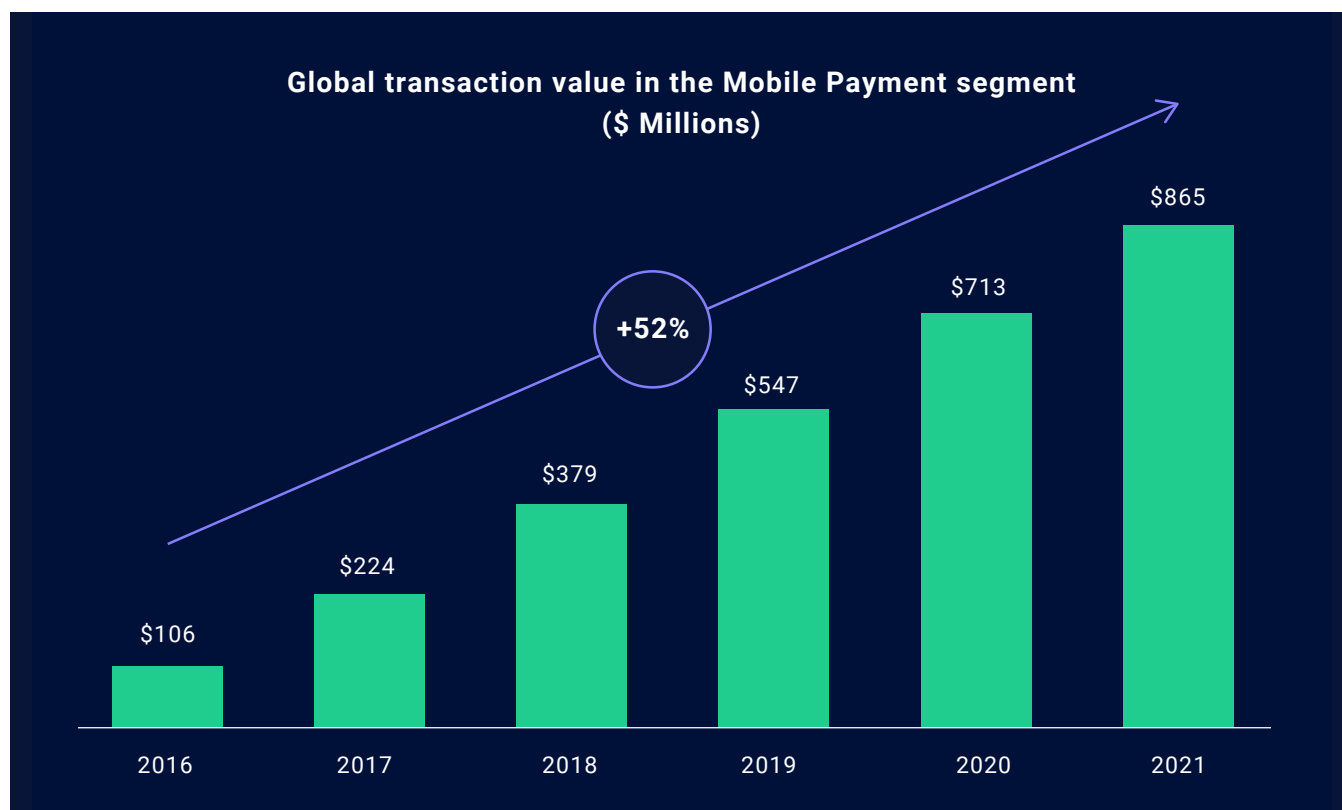
TRENDS IN THE PAYMENTS SECTOR

Consumer Trends

- **Growth in mobile applications based payments and mobile wallets**

Application based payments such as Alipay and WeChat in China and Paytm are predominant in Asian countries where credit and debit cards are not as ubiquitous as the West. Yet they have already siphoned away as much as \$40 billion in revenue from banks and processors. Although these companies were initially peer to peer platforms, they have added more features like account deposits. This spells big trouble for banks who rely on consumer deposits for their funding needs. In addition to Apple Pay, Google Pay and Samsung Pay, Facebook looms large. With its Messenger and WhatsApp platforms, which boasts billions of users, the world's largest social media network could emerge as a formidable player in payments.

Exhibit 10: Transaction via mobile devices rise steadily through to 2021 [\[10\]](#)



- **Technological improvements in cybersecurity**

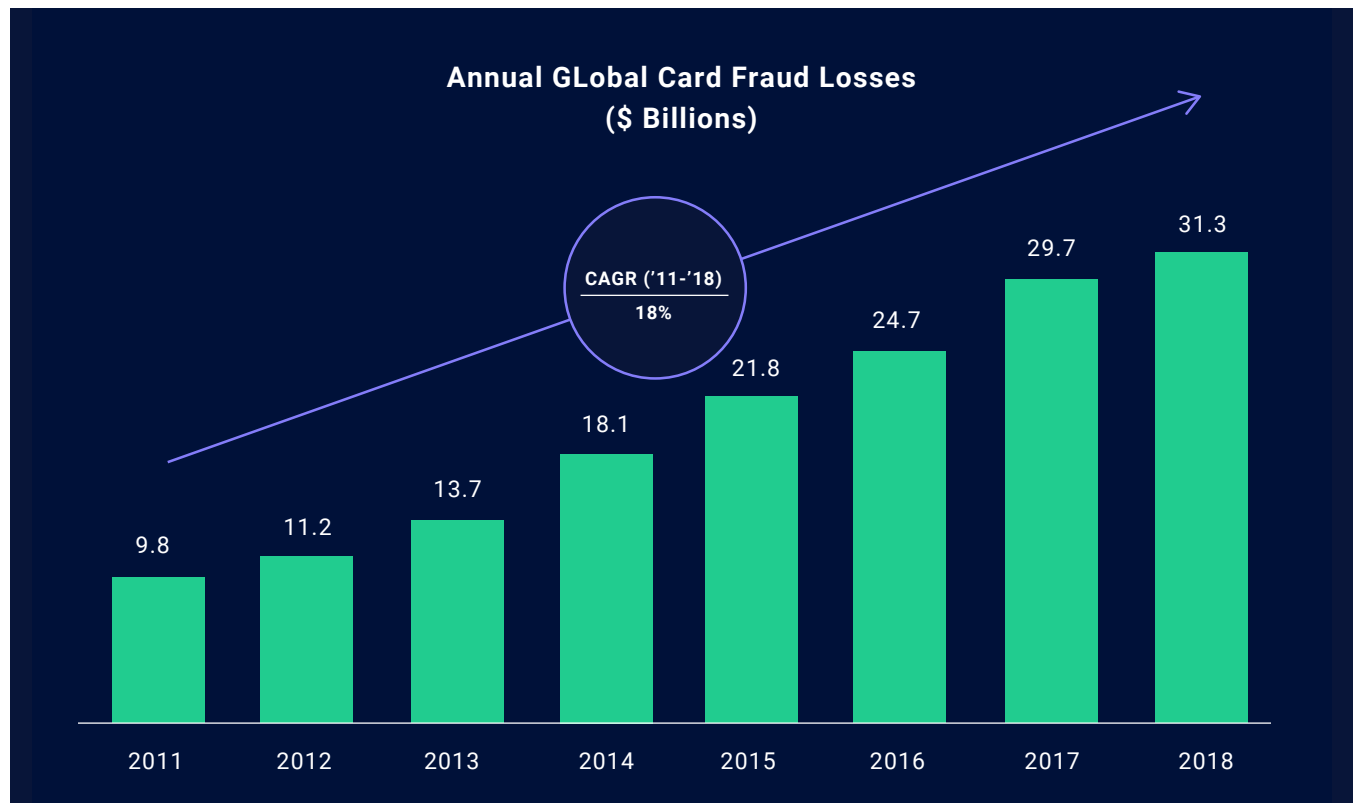
With advancements in computing power, companies are using enhanced protections at the point of sale, including security chips for additional authentication and biometrics and facial recognition to secure mobile transactions. Apple, Samsung and Google are industry leaders in these technologies.

Technology Trends

■ AI and machine learning used for fraud detection and customer retention

Payment processing has become a commodity business that primarily competes on pricing. Therefore, companies are using AI and machine learning to better understand consumer behavior and craft more targeted products and services. Over the past decade, credit card fraud has been consistently growing at 18 percent CAGR. We expect that number to grow as fewer people use cash. As a result, MasterCard, Visa and PayPal are using machine learning quickly detect fraud during payment authentication, saving millions in potential cyber thefts. For learn more about cybersecurity, please read our report [here](#).

Exhibit 11: Transaction via mobile devices rise steadily through to 2012 [11]



■ Blockchain technology gains traction for remittances and cross-border

Payments Sending money overseas is time consuming and inefficient. Using Blockchain eliminates the need for intermediaries and nostro/Vostro accounts to ensure faster, cheaper and secure cross border transactions. Companies such as Ripple, Circle and Wyre are building Blockchain infrastructure and several banks are already experimenting with this technology. Once governments establish regulatory standards, we expect widespread adoption of Blockchain.

Secular Trends

- **Consolidation of payment services**

Companies such as PayPal, Square, Stripe and Adyen are expanding their roles in payment processing. PayPal's recent acquisition of iZettle, a point of sale payments company, is further evidence that the industry needs to consolidate to preserve profits. We also see several banks like Citi and Wells Fargo move into payment processing.

- **Increasing collaboration of traditional banks with the fintech companies**

With the arrival of new technologies and competition, incumbent traditional banks must increasingly collaborate with tech firms in order to stay relevant. Banks can use open Application Programming Interfaces (APIs) to become more agile, accurate and efficient and exploit data to improve customer experience and provide customized products.

- **Adoption of instant/real-time**

Led by Europe, central banks and financial institutions around the world are building infrastructure to enable instant settlement of transactions. These upgrades will help businesses and customers and allow banks to compete with the non-banks for payments. Enabling real-time payments helps provide greater liquidity to small businesses and corporations with decreased clearing and settlement times for customer transactions.

Regulatory Trends

- **Expect more regulation on data compliance with growing cyber threats**

For banks, collaborating with payment companies has become a double edged sword. They need partnerships to keep their market share and retain customers but they are leaving systems vulnerable to potential cyber threats. Following high profile attacks on Target, Yahoo and Equifax, regulators are now increasingly focusing on consumer data protection and levying heavy fines for non-compliance.

- **Payment Services Directive (PSD2)**

The European Union designed PSD2 to weaken banks' monopoly on consumer data. The law allows businesses and merchants to complete a payment without using a third party like PayPal or Visa. With permission, the merchants can directly access bank account data and eliminate middle men, thus making payments faster and more efficient. Banks must also share their APIs, which means third party service providers can access valuable consumer data. We expect other countries to adopt this regulation over the next few years.

- **General Data Protection Regulation (GDPR)**

The European Union created this regulation to prevent companies from misusing personal data. The law restricts the ways banks and payments firms can use and process data and requires them to report data breaches to relevant authorities within a specific time period or face millions of dollars in fines.

“There’s going to be more change in the next five years in financial services than happened in the past 30.”

Dan Schulman
CEO of Paypal in Nov 2017 in an interview with CNBC

NOTABLE COMPANIES IN THE PAYMENTS INDUSTRY

There are several large public and private companies in the payments industry: banks, payment processors gateway validators, and most recently technology, e-commerce and messaging companies. With the industry long awaiting a disruption, there awaits huge opportunity in this space for all big and small players. We expect eventual consolidation in this space as competition and pressure on margins grows.

Private Sector

Payments is a popular sector in the private tech space across the United States, Asia, and Europe. Alipay, Tencent and Paytm from Asia have been leaders in e-commerce and messaging applications; Stripe, Adyen and Klarna have focused on back end payment processing. The industry's growth prospects has boosted private valuation: 9 out of 10 payments companies are already unicorns with 4 companies exceeding a \$10 billion valuation. Adyen's recent IPO and subsequent 60 percent stock price gain confirms the investor confidence in this sector. The 10 companies raised over a combined \$15 billion, with Alipay and Paytm accounting for 80 percent of that amount. In the United States, Stripe boasts a \$9 billion valuation and has raised \$440 million.

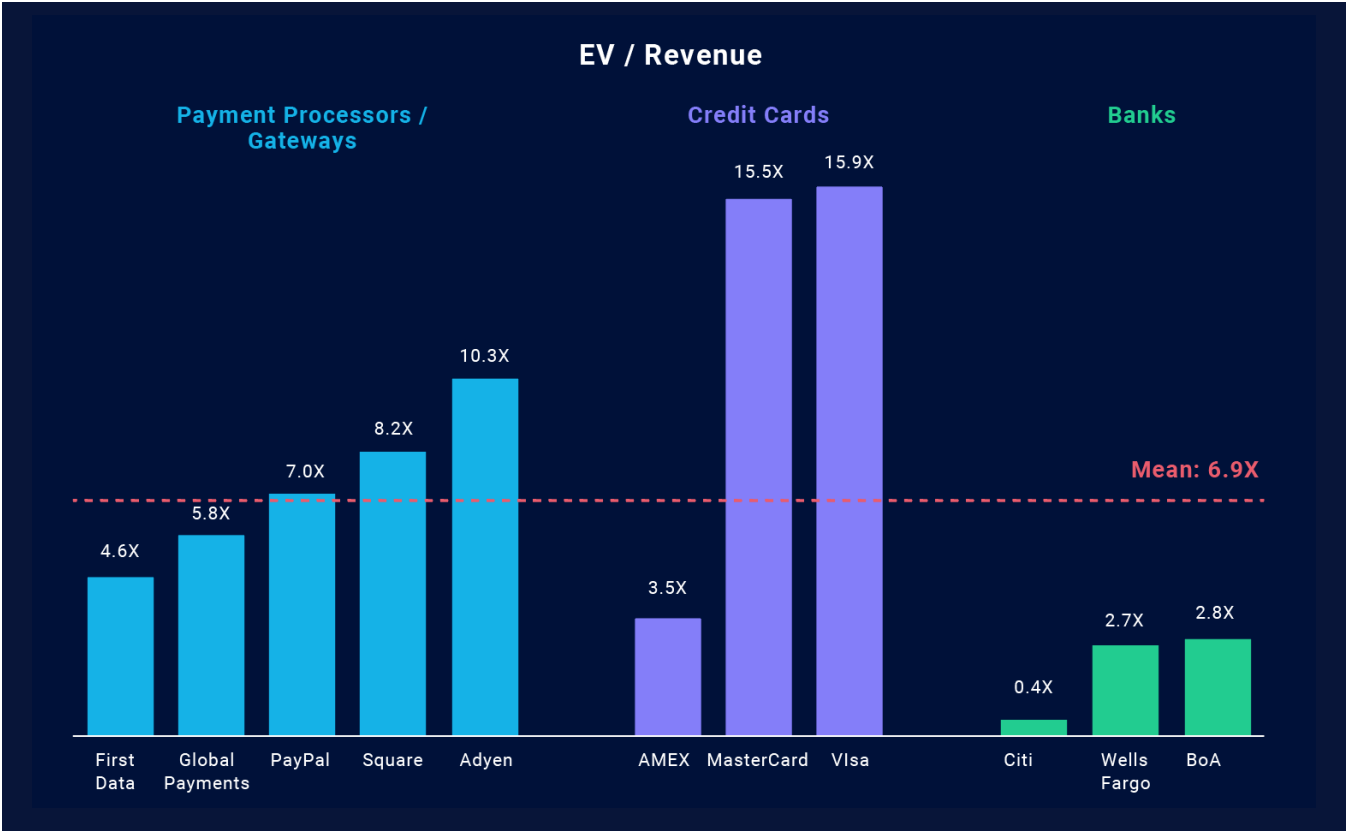
Exhibit 12: High valuations of private payment companies globally [12]



Public Sector

Credit card companies still command the largest transaction volumes and with a global footprint. Thus they enjoy higher Enterprise Value/Revenue multiples compared to the banks and payment processing firms. But payment processors are catching up, thanks to expanded offerings and enabling cardless transactions. The chart below shoes revenue multiptles for newer payment companies have been growing: First Data at 4.6x , Adyen at 10.3x.

Exhibit 13: Public Comparables have a range of revenue multiples: 0.4x - 15.9x [13]

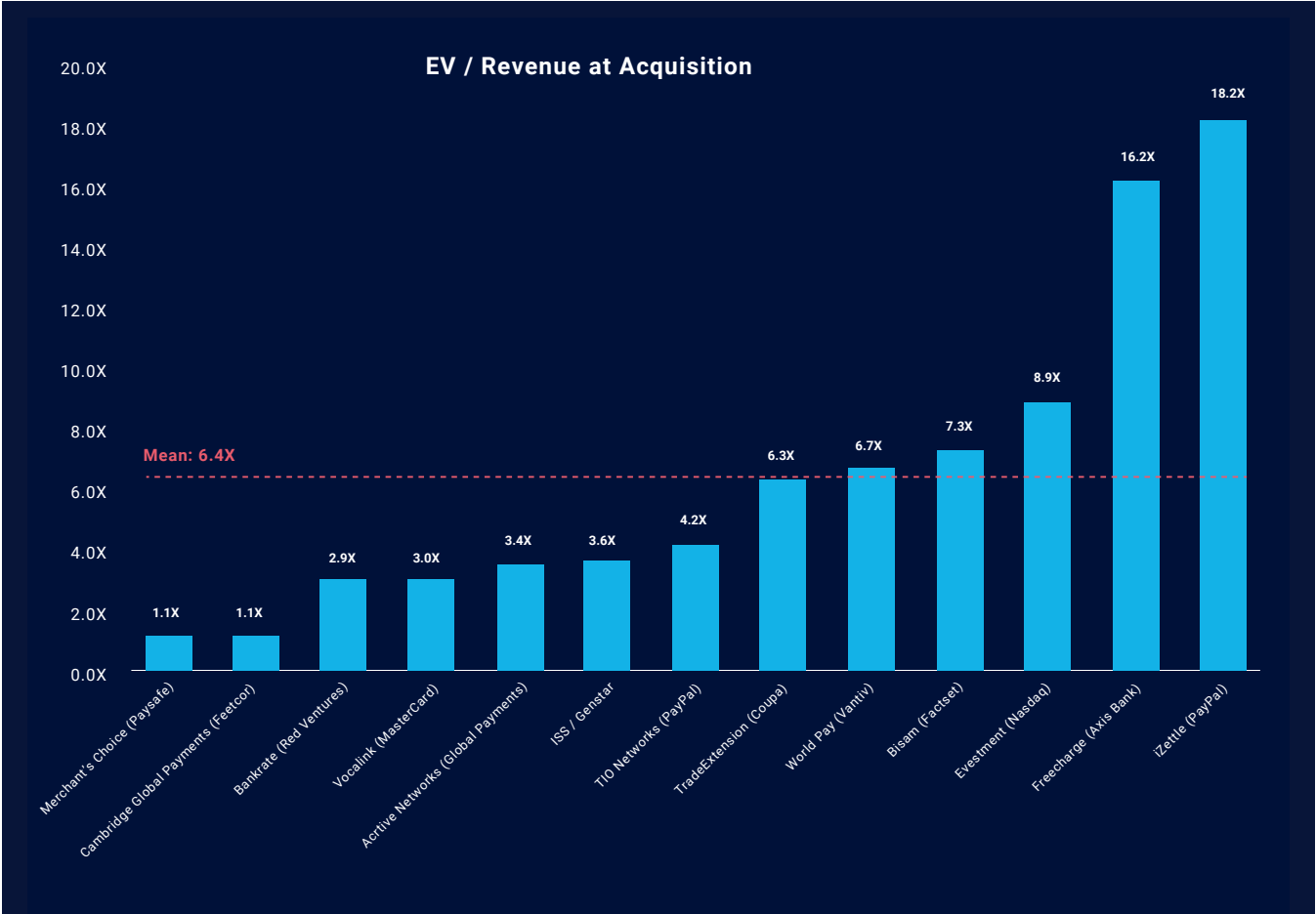


NOTABLE M&A IN THE FINTECH SPACE

Global M&A in fintech has been quite active over the past decade. The number of fintech deals have grown to 900 by end of 2017 compared to 600 in 2010. Below is a list of select M&As and their revenue multiples (acquisition price and last known revenues).

On average, the EV/Revenue over the past year is an estimated 6.4x, close to what we see for public payment companies today. The 18.2x multiple PayPal paid for iZettle demonstrates investor confidence in this industry. We expect to see further consolidation either through M&A or partnerships to better address consumer needs, whether card, cash, mobile or other forms of payments.

Exhibit 14: Fintech M&A increasing as companies get global [\[14\]](#)



INVESTMENTS IN FINTECH AND PAYMENTS

Since 2014, investors have poured over \$130 billion into fintech companies, \$40 billion last year alone, thanks partly to Blockchain startups. We've seen 1,800 deals in 2017 and close to 200 as of the first quarter of 2018. OneConnect, Credit Karma, Armour and Robinhood have attracted \$2 billion in the first 3 months of this year. Top investors, including 500 Startups and Y Combinator, participated in over 10 percent of the overall fintech deals in 2017.

Exhibit 15: Over \$40 billion invested in Fintech space in 2017 [\[15\]](#)

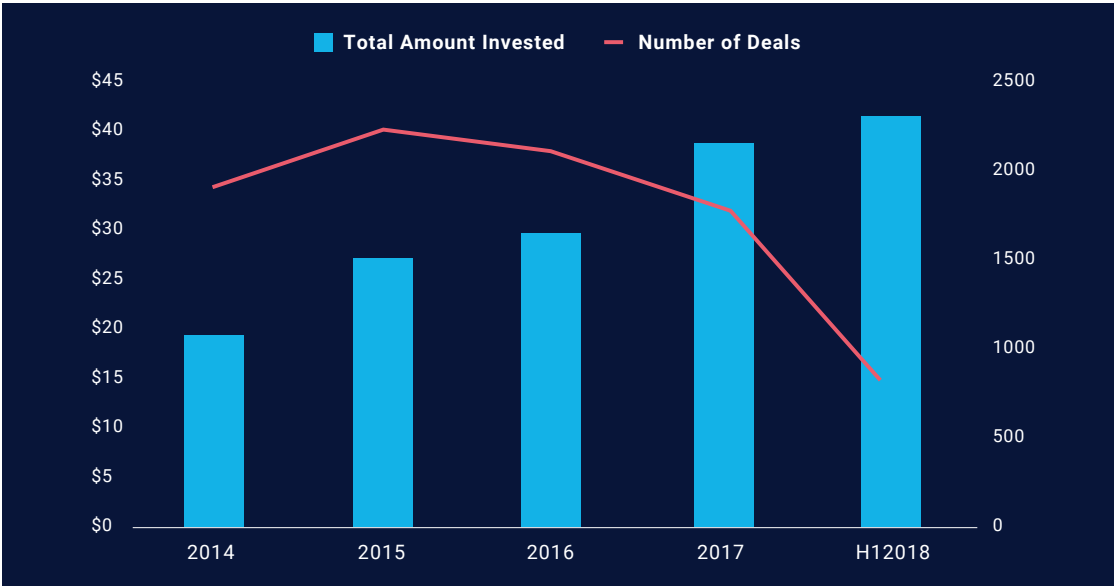
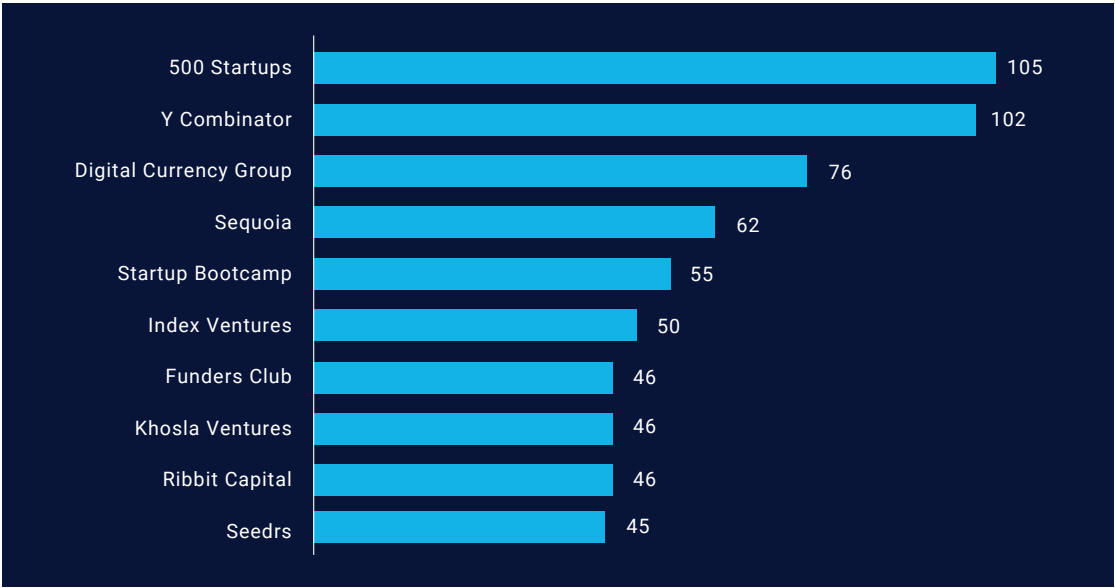


Exhibit 16: Over 630 deals were made by just the top 10 investors in 2017 [\[16\]](#)



Fintech also boasts the largest number of unicorns after e-commerce. Out of the 237 unicorns in 2017, over 25 were fintech firms. With Adyen, GreenSky and iZettle enjoying successful exits, we expect to see this list to grow in 2018. Payment startups, in particular, have attracted the most interest; over 30 percent of VC and seed money went to such firms. Cryptocurrencies were the second most popular fintech investment, most of which focused on the payments industry.

Exhibit 17: Fintech is the second largest sector amongst the 237 Unicorns globally [\[17\]](#)

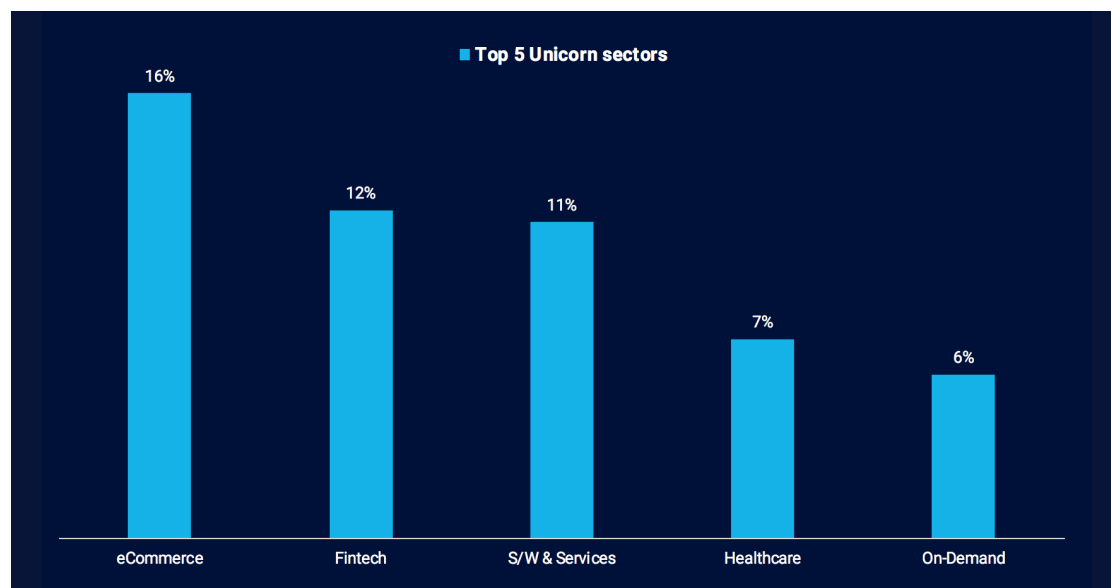
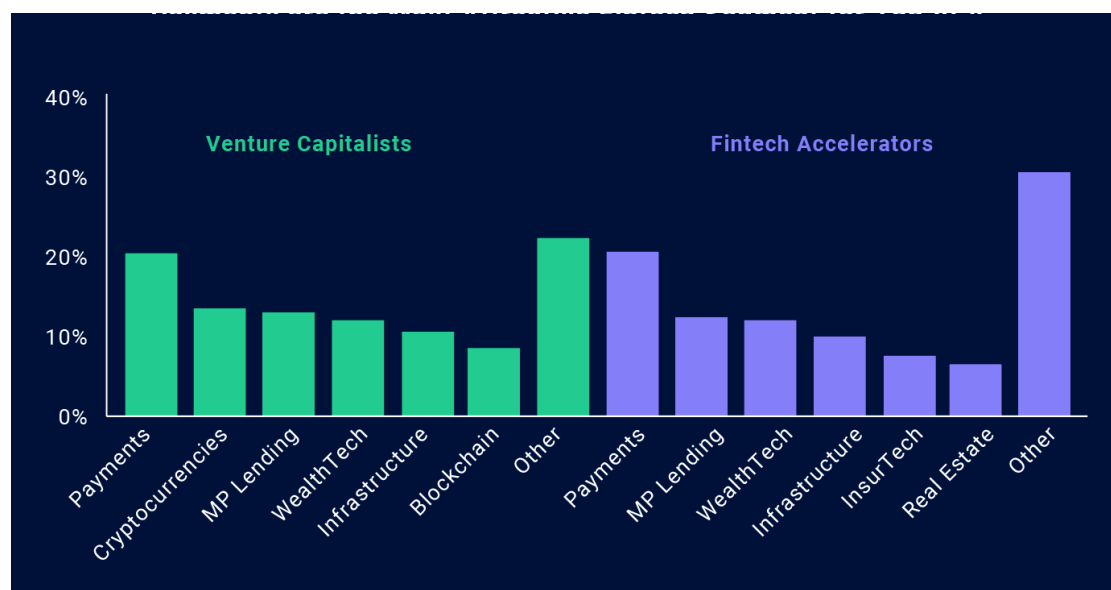


Exhibit 18: Payments is the most attractive Fintech segment for investors [\[18\]](#)



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SOURCES

- [1] SharesPost Research; 2016 McKinsey Report on Global Payments
- [2] SharesPost Research
- [3] SharesPost Research; PayPal investor day 2018
- [4] SharesPost Research; McKinsey Report “How Value Creation Is Reshaping The Payments Industry”
- [5] SharesPost Research; publicly available information for 2017; Adyen numbers based on their IPO filings
- [6] SharesPost Research
- [7] SharesPost Research; Various publicly available information on payments
- [8] SharesPost Research; publicly available information
- [9] SharesPost Research; publicly available information
- [10] SharesPost Research; https://www.slideshare.net/statista_com/mobile-payments-growth-country-comparison-usage
- [11] SharesPost Research; CapGemini Report: “ Top 10 Trends in Payments 2018”
- [12] SharesPost Research; PitchBook; the above list does not include WeChat which is a part of Tencent Holdings; Adyen went public in June 2018
- [13] SharesPost Research; Yahoo! Finance
- [14] SharesPost Research; PitchBook and various news articles to get estimates on the last known revenues for the acquired companies
- [15] SharesPost Research; <http://fintech.global/fintech-companies-raised-10bn-across-387-deals-in-q1-2018/>
- [16] SharesPost Research; <http://fintech.global/the-top-10-most-active-fintech-investors-in-fintech-made-over-600-deals-since-2014/>
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