VEF

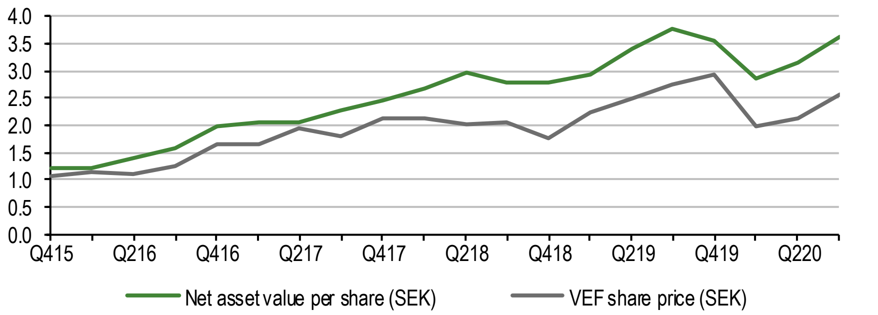
Initiation of coverage

Digitalisation dynamo

Investment company

VEF is a unique, fairly young company focused on fintech in emerging markets where financial services are underpenetrated and populations are jumping straight to digitalisation, with COVID-19 accelerating this trend. It is particularly focused on Brazil, which offers enormous growth potential with over 200 million people, high online penetration, scalability, incumbents with concentrated market shares and high pricing, and regulatory support for fintechs. VEF trades at a discount to NAV (13%) following a 20% NAV increase in Q320 and could offer a very attractive entry point for growth-oriented investors who cannot easily get exposure to this asset class. Its track record is limited, but realisations so far have made a 65% IRR, and VEF is backed by highly regarded shareholders.

Upward quarterly performance since inception



Source: VEF, Refinitiv

The market opportunity

Financial services are becoming increasingly digitalised and emerging markets offer a greater growth profile than more developed countries. KPMG estimates that global fintech investment activity rose from $18.8bn in 2013 to $137.5bn in 2019. Accenture calculates that in Europe 33% of all new financial services revenue since 2005 has been captured by fintech companies. Continued strong investor appetite from new entrants and incumbents should help exit prices on VEF's investments.

Why consider investing in VEF?

- VEF offers diversified access to well-managed private companies with disruptive business models at an early to mid-growth stage.
- Emerging and frontier markets tend to offer superior long-term growth profiles.
- VEF is an active investor with board seats on all its portfolio companies. Its track record is good, although short, with two very profitable exits.

Valuation: Trading at a 13% discount to NAV

VEF is trading at a 13% NAV discount. Underlying assets are valued under a mark to model approach (normally on a revenue multiple) or on a recent transaction basis. The portfolio is on an FY19 revenue multiple of 17x, but revenue quadrupled in the two years to FY19 and we believe strong momentum should continue.

6 November 2020

Price	**SEK3.15**
Market cap	**SEK2,090m**
AUM	**US$268m**
	SEK8.5/US$
NAV per share	SEK3.63
Discount to NAV	13%
Shares in issue	663.4m
Free float	100%
Code	VEFL
Primary exchange	Nasdaq First North (Stockholm)
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	9.0	13.8	15.4
Rel (local)	9.9	7.7	4.2
52-week high/low		SEK3.41	SEK1.74

Business description

VEF (formerly Vostok Emerging Finance) is an investment company taking equity positions in early stage fintech companies in a broad spectrum of financial services in emerging and frontier markets.

Next events

Q420 results	February 2021

Analyst

Pedro Fonseca +44 (0)20 3077 5700

investmenttrusts@edisongroup.com

Edison profile page

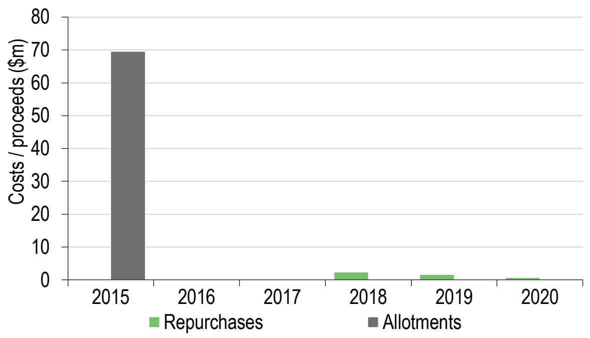
VEF is a research client of Edison Investment Research Limited

Exhibit 1: Company at a glance

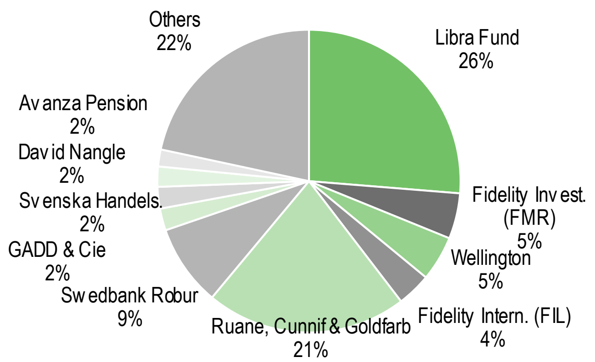
Investment objective and company background	Recent developments
VEF (formerly Vostok Emerging Finance) is a closed-end investment company, domiciled in Bermuda and listed in Stockholm. It invests in minority (typically 10–25%) equity stakes in early stage fintech companies in emerging and frontier markets. Management often takes an active role in boards and the company seeks to make above-average returns with exit sales. It looks for entrepreneurs and teams with good track records, viable concepts and strategies with scalable business models that can deliver high rates of growth. It prefers markets with significant single-country scalability potential. VEF does not target dividend pay-outs unless the outlook for new investment opportunities suggests otherwise.	■ 4 November 2020: Q320 report: net result US$44.4m (Q319: US$10.7m), NAV +20.0% q-o-q (US$), NAV +15% q-o-q (SEK). ■ 30 July 2020: Q220 report: net result US$36.7m (Q219: US$35.5m), NAV +19.7% q-o-q (US$), NAV +11% q-o-q (SEK). ■ 13 May 2020: No dividend payment confirmed in AGM. ■ 29 April 2020: Q120 report: net result a loss of US$62.2m (Q119: US$1.6m), NAV -5.3% q-o-q (US$), NAV -19.2% q-o-q (SEK). ■ 31 March 2020: VEF announces US$13m investment in Juspay, an Indian fintech payments company.

Forthcoming		Capital structure		Company details	
AGM	May 2021	Ongoing costs	2.25%, FY19	Group	VEF
Year end report	February 2021	Net gearing	Zero	Manager	Team
Year end	31 December	Annual mgmt fee	None	Address	Clarendon House 2 Church Street Hamilton HM 11 Bermuda
Dividend paid	None to date	Performance fee	Bonus scheme, see page 17		
Launch date	17 July 2015	Company life	Indefinite	Phone	+46-8 545 015 50
Continuation vote	None	Loan facilities	None	Website	vef.vc

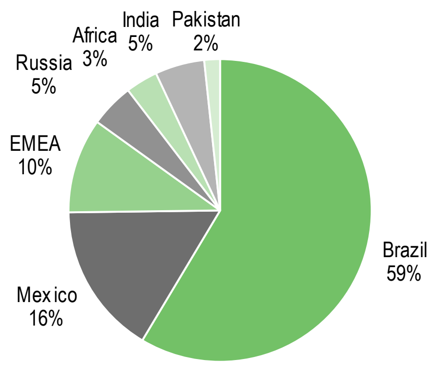
Dividend policy and history (financial years)	Share buyback policy and history (financial years)
VEF does not pay any fixed dividends. This may change depending on investment exits and opportunities.	VEF raised US$70m in Q415. Since then it has purchased some shares in the market over 2018 to 2020, mainly for its management bonus incentive scheme. The shares therefore have not been cancelled.



Shareholder base (at 31 October 2020)



Geographic breakdown at 30 September 2020



Top five holdings (at 30 September 2020)

Company	Country	Sector	Portfolio weight %	
			September 2020	September 2019
Creditas	Brazil	Consumer secured credit	38	29
Konfio	Mexico	Small business finance (mostly unsecured)	15	16
TransferGO	EMEA	Digital money transfer	9	5
Juspay	India	Merchant payments platform	5	0
Nibo	Brazil	Accounting software service provider	5	3
Top five total			**72**	**53**

Source: VEF, Edison Investment Research, Refinitiv

Emerging fintech disruption

Although financial services may have traditionally been more resilient to disruption by technology, this is now clearly changing. These changes were initially slow due to both competitive barriers (such as expertise, regulation, economies of scale and the importance of trustworthy brands) as well as inertia on the customer side. However, fintech companies are increasing their share of financial service revenues, especially in the retail sector and in segments such as payments. The technology advantage can arise from various angles including better collection and usage of customer data, superior service delivery and higher automatization. Accenture estimates that in Europe, 33% of all new financial services revenue since 2005 has been captured by fintech companies.

According to KPMG, investment activity (venture capital, private equity and M&A) in global fintech rose from $18.8bn in 2013 to $137.5bn in 2019. According to the FinTech Almanac, fintech activity in South America (VEF's current largest geographic weighting) increased from $434m in 2015 to $1.8bn in 2019.

The recent lockdowns likely increased this trend of digitalisation, because fintechs benefit from the erosion of the advantages of physical distribution.

Emerging markets offer further upside

In addition to the digitalisation trend, emerging markets offer further upside from greater long-term growth profiles. There are segments and niches that traditional banking in emerging markets has overlooked or not captured well and there are more underserved clients in many of these markets. Clients are moving directly to digital platforms and bypassing bricks and mortar banking. This is particularly true in the relatively poorer emerging markets such as India, Pakistan or Africa, where the level of financial integration is still comparatively low. According to the World Bank, in 2017 the percentage of the population with a bank account was 21% in Pakistan and 31% in Africa compared to 96% in the EU.

Fintech investment activity has been growing strongly in emerging markets as a result. Especially in Latin America. The value of fintech deals and financing in Latin America was just $44m in 2013 and was about $2bn by 2019. According to Statistica, of this $2bn, 70% was in Brazil and 21% in Mexico.

Should investor appetite for the emerging market fintech sector remain strong, this will help exit strategies for investors such as VEF, which tend to invest in companies at earlier growth stages. One option is to list companies on the market, which also helps crystalise value. The businesses can also be sold to new entrants as well as competitors (including incumbents) seeking to consolidate the market.

Many different opportunities

Different emerging markets will have varying interesting fintech propositions. These will be shaped by various factors such as different needs, varying levels of specific customer receptivity, regulatory support, levels of development and income. The common thread is the use of technology to bring these services to customers usually at a lower cost, more quickly and/or with a more user-friendly approach.

VEF's portfolio is a good example of the various opportunities that can be targeted. These include underserved customers such as Mexican small businesses and African clients with limited access to financial services. There are Brazilian retail customers tired of being unnecessarily burdened with expensive consumer loans. Another of VEF's investments is bringing wealth management services and tailored investment portfolios to the mass market in Brazil. In India, the clients are merchants that want an efficient platform to manage the wide range of existing electronic payments.

It seems certain that financial services in emerging markets will continue to change and further embrace the digitalisation trend. To be successful in this competitive marketplace, brand strength, sufficient funding and economies of scale are crucial to gain significant market share.

Company profile: An emerging fintech active investor

VEF (formerly Vostok Emerging Finance) was launched in November 2015 and is headquartered in Bermuda. Its Swedish Depository Receipts (SDRs) are listed on the Nasdaq First North exchange in Stockholm. Each SDR is equivalent to one ordinary share and has the same voting rights with no restrictions. Throughout this note when we refer to VEF's shares, we are referring to these SDRs.

VEF was spun out of Vostok New Ventures (which has changed its name to VNV Global), a Swedish-based investment company that has been making emerging markets investments since 2007. Vostok New Ventures can be traced back to an investment company named Vostok Gas (itself called Vostok Nafta prior to 2007) that made oil and gas investments in the former Soviet Union from 1996 and has been defunct since 2012. VNV Global's emerging market focus is wider than just fintech and VEF was launched to focus on this segment. VEF seeded with Vostok New Ventures' equity position in TCS Group, which holds the Russian fintech bank Tinkoff.

Innovative and scalable businesses

VEF's investment targets are early to mid-stage modern financial services companies in emerging and frontier markets. The company looks for innovative early stage companies capable of challenging incumbent companies with new thinking and modern technology solutions. It also looks for entrepreneurs and teams with good track records, viable concepts and strategies and clear, scalable business models that can deliver high rates of growth.

VEF can invest in the whole spectrum of financial services. The portfolio includes firms in consumer credit, payment solutions, money transfer, personal finance, asset management and various types of financial marketplace.

There is a strong preference for larger emerging markets where single-country scalability can provide greater returns. The investments have therefore been in large markets such as Brazil, Mexico, India, Russia, Turkey, Pakistan and Africa.

Although VEF's mandate gives it more flexibility, it typically aims for a 10–25% minority equity stake. Where appropriate, the team seeks board appointments where it can add value by knowledge, corporate governance investment profile and networks for capital raising and partnerships. David Nangle spent 15 years analysing emerging market financial companies at ING and Renaissance Capital before becoming VEF's CEO. Alexis Koumoudos, investment partner since 2016, has five years of emerging market hedge fund experience (Skyline Capital Management). Henrik Stenlund (CFO) has extensive experience in the media sector.

The average investment duration is expected to be five to seven years, but ultimately this is determined by exit opportunities including unsolicited bids. The permanent capital structure of a closed-end fund gives VEF flexibility in managing its holdings. VEF has made two impressive exits so far, Tinkoff (Russian digital bank, Q119) and Iyzico (Turkish online payments, Q419), for an average 65% internal rate of return (IRR). There is no regular dividend target, with the focus being on capital appreciation.

Company management

The manager's view

Management believes VEF's companies are set up to function in the high political and economic volatility of emerging and frontier markets, which may make them more resilient to the impact of COVID-19. The resilience comes from management being more accustomed to macro volatility and the secular growth opportunity that helps VEF ride out the negative shocks. VEF focused on cash conservation over growth in the first half of 2020, although it concluded one investment (Juspay in India) in March, which was already close to completion.

VEF sees fintech as being positioned to benefit from the structural changes to business and consumer practices as a result of the pandemic. This includes a significant shift to digital channels for financial services and away from cash and branch queues. The team believes personal finance and wealth management tools are increasingly in vogue. This secular trend of doing more online was reinforced by the lockdown and the resulting new working and social dynamics.

VEF has been pleased with the performance of several of its companies during the pandemic crisis of 2020. The business volumes continued to grow at a strong pace in these companies and as a result several were revalued upwards after being cut in Q120 at the start of the lockdown. This includes Creditas and TransferGO. Juspay is a recent transaction whose book value is still at cost and has not been adjusted, but VEF also highlighted that volume growth strengthened during the lockdown as online shopping increased. Together these three companies account for just over 50% of VEF's net asset value (NAV) and led portfolio NAV to be revalued up by 20% in Q220.

In Q320, portfolio NAV was revalued up by a further 20%. This was largely due to Creditas (again) and Konfio. The former had already shown a resilient performance in Q220 and increased the pace of revenue growth in Q320. Konfio had initially been negatively affected by the pandemic and marked down, but has now been revalued as VEF moves 'away from conservative forecasting and a short-term valuation approach, in line with clear recovery trends in the company's financials'.

Management sees an increased level of IPO and M&A activity across the emerging market fintech space. This is a positive for exit liquidity in the sector and increases the transparency of the value in the portfolio. Management continues to see outside investor interest in its portfolio companies.

Management sees a growing opportunity to deploy capital effectively in current and new assets, but will remain patient with a high investment bar. Pipeline work has intensified through Q320 and management expects to convert this into new investments in the coming months.

Investment process

VEF splits its investment process into five phases. The first is the sourcing stage and is always ongoing. Sourcing is done on a country-by-country approach. VEF works and speaks with private players, venture capital funds, listed players and incumbents to identify attractive opportunities and teams. Management looks at various top-down drivers. Drivers such as tech adoption, behaviour and regulation help identify segments of focus. VEF also looks at the capital markets backdrop, funding sources and exit environments in choosing its targets to analyse. Economics, demographics and cultural aspects also play a role.

The second phase is usually the longest and this is where VEF spends time getting to know the company, people and competitive environment and builds a rapport. VEF estimates this screening process typically takes anywhere from three months to 1.5 years.

If the opportunity looks interesting, then an investment proposal is made to the investment committee. The investment committee is aware of upcoming opportunities and usually has input before they are formally presented to them. The company board constitutes the investment committee.

This is followed by due diligence using third-party experts where necessary before the closing stage. The last three stages typically take three to five months.

The portfolio

At 30 September 2020, VEF's portfolio consisted of 12 equity investments with a fair value of US$248m and US$20m in cash (this includes US$18m designated as 'liquidity management'). There is no debt and less than US$1m in liabilities for a company NAV of US$268m. The total amount invested on the current assets is US$196m.

Companies can be split geographically or by sub sector. Of the 12 companies, 10 can be grouped into three areas of primary activity:

- **Payments and remittances companies**: Juspay, Jumo, Revo, TransferGO and Finja operate in this segment, which naturally lends itself to the global digitalisation trend.
- **Digital lending**: Creditas (which is an asset light company) and Konfio produce and sell their own lending products in this segment.
- **Finance management and marketplace:** in this segment, the money is made by selling commissions rather than underwriting risk. FinanZero is a loan marketplace that tries to find the best deal for customers from its many partners. Guiabolso offers personal finance management tools and wider products for sale. Magnetis brings wealth management services to more people at lower cost by using robo-advisers.

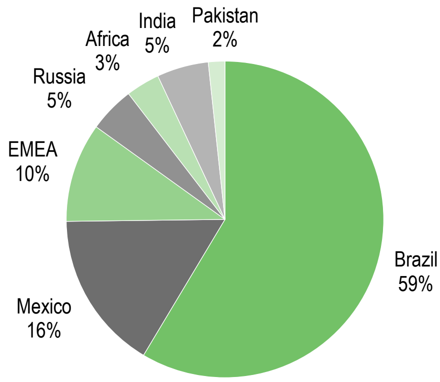
Although the core of each company is its technology, they have different value drivers and competitive challenges. So, even though there is some country concentration in Brazil, the catalysts for performance are not always the same. Some companies may be more exposed to the credit cycles, others to the financial markets and others such as Nibo are more resistant to the economic cycle.

Exhibit 2: VEF investment portfolio

US$000s Company			Net invested Q220	FV FY19	Invest. change ytd Q320	FV Q220	FV Q320	Q-o-q (%) FV Q320	Ytd (%) FV Q320	Portfolio weights (%) Q220	Valuation method*
Creditas	Brazil	Dec-17	48,500	73,246	0	80,713	102,078	26%	39%	38%	M
Konfio	Mexico	Jun-18	27,500	41,579	0	28,081	40,279	43%	-3%	15%	C
TransferGO	EMEA	Jun-16	11,037	12,555	2,111	21,428	25,167	17%	100%	9%	M
Juspay	India	Mar-20	13,000	0	13,000	13,000	13,066	1%		5%	R
Nibo	Brazil	Apr-17	6,500	10,619	1,200	11,290	13,000	15%	22%	5%	M
Revo Group	Russia	Sep-15	8,789	16,244	0	10,222	11,585	13%	-29%	4%	M
Guiabolso	Brazil	Oct-17	30,000	11,545	0	9,601	8,956	-7%	-22%	3%	M
FinanZero	Brazil	Mar-16	2,671	7,728	0	7,576	8,747	15%	13%	3%	M
JUMO	Africa	Oct-15	14,614	16,875	0	7,497	8,551	14%	-49%	3%	M
Magnetis	Brazil	Sep-17	5,668	8,108	0	6,616	7,695	16%	-5%	3%	C
Xerpa	Brazil	Sep-19	8,500	8,500	0	4,544	4,931	9%	-42%	2%	C
Finja	Pakistan	Jul-16	2,425	3,389	425	2,457	4,181	70%	23%	2%	M
Liquidity management			16,965	34,521	(16,500)	18,047	18,033	0%	-48%	7%	
Investment portfolio			**196,169**	**244,908**	**236**	**221,073**	**266,269**	**20%**	**9%**	**99%**	
Cash and cash equivalents				5,562		2,545	2,141	-16%	-62%	1%	
Total investment portfolio				**250,470**		**223,618**	**268,410**	**20%**	**7%**	**100%**	
Other net liabilities				(1,031)		(382)	(236)	-38%	-77%	0%	
Total Net Asset Value				**249,439**		**223,236**	**268,174**	**20%**	**8%**	**100.0**	

Source: VEF. Note: *M = marked to model, R = recent transaction, C = calibration method.

Exhibit 3: Portfolio geographic breakdown (ex-cash) Q320



Source: VEF

Brazil is an exciting opportunity

VEF's relatively high weight in Brazil reflects the level of opportunities in the market that VEF management has identified.

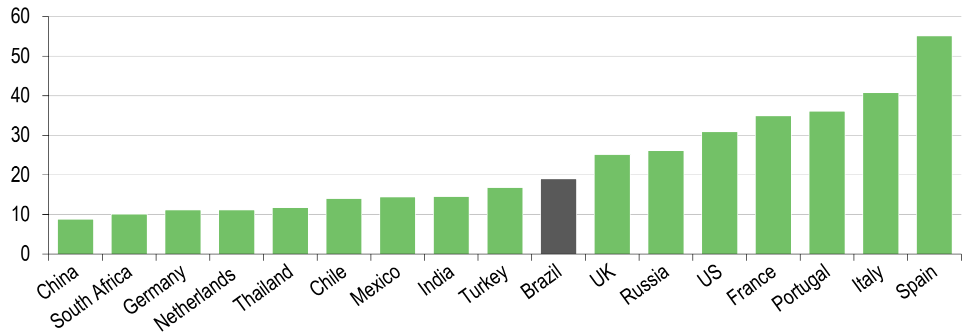
The opportunities can be summed up as:

- **Large single-country scaling**: Brazil fits VEF's preference for markets with large single-country scaling ability. Brazil has a population over 200 million people and a US$1.6tn economy. It is a typically favourable emerging market with a relatively young population.
- **Concentrated, expensive financing services:** in Brazil, the top five banks (three private, two state controlled) have close to 85% of lending market share. Furthermore, they tend to have a strong presence in many of the key financial services including asset management and insurance as well. Also, until the legislation was changed in 2018, banks were allowed to do deals with companies that would lock in the employee payroll with the bank. This has contributed to the high margins in most financial products and made these large banks less interested in innovation. They also have large and costly branch networks. Brazilian banks traditionally have had inefficient cost structures, but these have been covered up by the wide interest margins that allowed them to maintain good cost to income ratios. This creates a greater window of opportunity for better service with lower prices facilitated by technology.
- **Online and connected population:** Brazil shows a good degree of engagement and adoption with online platforms and mobile apps. Fintech adoption compares well with other countries; according to Ernst & Young's 2019 Global FinTech Adoption Index, 64% of Brazilians have adopted some consumer fintech. It ranked 16th out of 27 countries in the survey even though it was among the lowest in terms of GDP per capita. It also ranked above countries such as the US, France, Canada, Italy and Japan and had the same adoption rate as Germany, Sweden and Switzerland.
- **Regulatory support:** the Brazilian central bank and the government have been supportive of fintech with positive regulatory steps to encourage its development. Making financial services easier and cheaper has been a priority for the authorities. We expect further action in future, including the introduction of Pix and Open Banking in 2021 by the Brazilian central bank. Pix is an instant transaction platform that replaces the previous national payment system (TED). It will work 24 hours, seven days a week and allow instant payments including on mobile phones. Open Banking will have a phased introduction and will allow the sharing of data, products and services by financial institutions through opening and integration of platforms and infrastructure of information systems. A key aspect is that it will be at the customer's discretion how one financial institution can process data held by another institution. Although these changes will be

a challenge for some fintechs, the introduction of Pix and Open Banking show that the regulator is looking to digitalisation as the way forward for better financial services in Brazil.

Furthermore, VEF's ability to complete deals in Brazil has been helped by the busy activity in the fintech space and finding its partners, especially with regards to venture capital specialists.

Exhibit 4: Bank branches per 100k inhabitants (2018)



Source: World Bank https://data.worldbank.org/indicator/FB.CBK.BRCH.P5

Creditas (9.7% stake)

Creditas is a Brazilian online platform offering secured loans. Its initial and main focus is home and auto-backed loans. The business opportunity arises from the fact that unsecured consumer loans are quite expensive in Brazil and there is considerable unlocked equity value in Brazilian housing. According to the Brazilian Institute of Geography and Statistics (IBGE), 70% of homes are owned debt free yet many homeowners will take on consumer loans at these elevated rates. While the home equity loans from Creditas can be as low as close to 10% (typically indexed to inflation), the average unsecured loan rate in Brazil is close to 80%. This is in the context of 2% inflation per year and a 2% central bank policy rate (SELIC).

Mortgage market underpenetrated

Brazil has traditionally had a problem with inflation, which has resulted in a government yield curve and high interest rates that have not been conducive to long-term borrowing. This has contributed to the mortgage market being undersized and key retail lending products being very high interest rate, short-term, small-ticket unsecured lending. There has been a subsidised lending system for targeted areas of the economy. In the retail side of the economy, this has usually been mostly mortgages and rural credit.

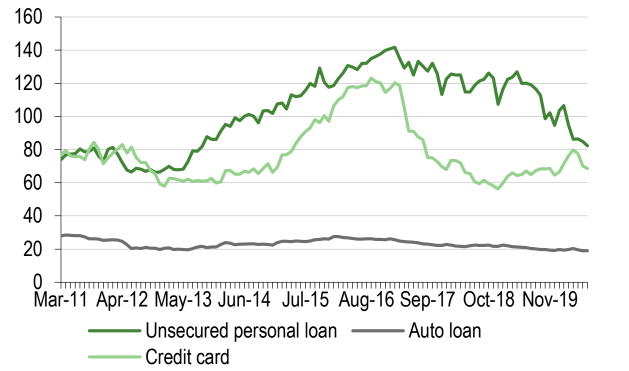
This special regime mortgage market (SFH) has had its limitations and, along with some other regulatory and judiciary issues in the past, has led to a significant amount of untapped equity in Brazil. Things have been changing on all fronts in Brazil, but mortgages still account for only 7% of GDP and consumer credit rates remain high. Brazil is a very aspirational culture and often consumers will take a loan even on usurious terms, as long as the monthly instalments are within their budget.

The introduction of payroll-deducted loans was a very important development in broadening access to credit to Brazilian retail customers. These loans were introduced in 2003 and were a viable alternative form of credit with relatively lower interest rates as they were secured by deductions at the source of monthly wages, initially for public sector employees and retirees/pensioners.

Unsecured loan rates more than 80%

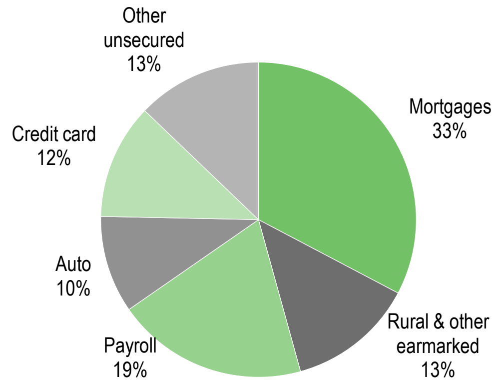
By July 2020, about 25% of household debt was in unsecured loans including credit cards, according to Brazilian central bank data (see Exhibit 6). This amounted to BRL508bn in July 2020. Creditas's loan book was BRL1bn in July. Although not all unsecured lending in the banking system is readily substitutable, a majority is so it is a target for home equity loans. The debt reduction burden is significant; the average unsecured personal loan rate is still more than 80% (Exhibit 5). In addition to allowing people to borrow at much lower interest rates, easing their credit burden, Creditas makes it easier to borrow by providing its services digitally.

Exhibit 5: Brazil average lending rates (%)



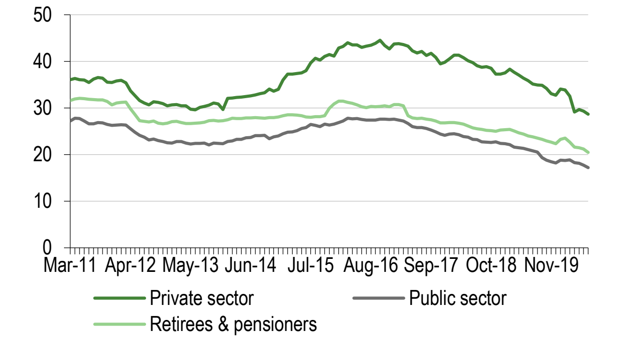
Source: Brazilian Central Bank

Exhibit 6: Brazil household debt breakdown (July 2020)



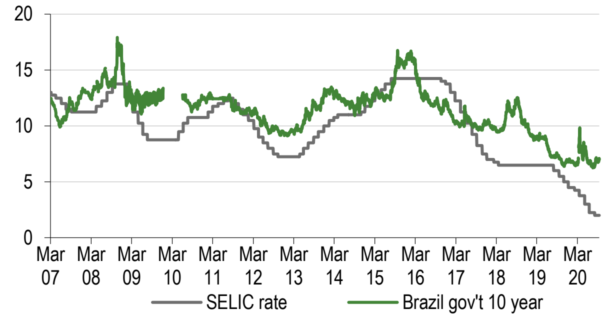
Source: Brazilian Central Bank

Exhibit 7: Brazil payroll deducted lending rates (%)



Source: Brazilian Central Bank

Exhibit 8: Brazil SELIC rate, 10-year gov't bond (%)



Source: Brazilian Central Bank

Creditas offers auto loans where its interest rates (16–18%) are competitive with peers, including banks. Creditas now offers direct auto loans for purchase in addition to its original offering of auto-backed loans.

The third key product for Creditas is the payroll-deducted lending segment. When introduced, rates were initially 6–7% a month compounded (so close to 100% a year) and clearly showed how close competition sometimes could be between the larger banks in Brazil. This has since come down but, as Exhibit 7 shows, the rates are still attractive. In July 2020, the public sector average interest rate for payroll deducted loans was 18% and the average for retirees and pensioners was 21%. The private sector borrowing rate is higher at about 30% due to the higher risk profile. These are attractive lending rates given the risks and it makes sense for Creditas to target this market.

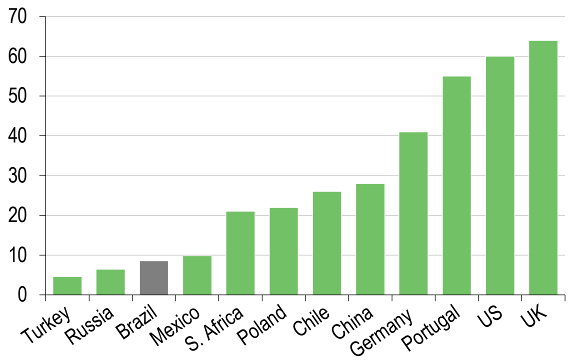
Creditas also augments its product offering by providing loans around its core products with a view to further increase client retention. For example, it offers home renovation loans or advances on house sales in addition to its home equity loans. And it offers vehicle storage solutions and car repair loans to complement its auto equity loans.

The average ticket sizes for Creditas in home equity, vehicle-backed loans and payroll deducted loans are BRL200,000, BRL18,000 and BRL6,000, respectively. Creditas is looking to add further products (such as advanced salary loans), while its Mexican operations, which began this year, have already contributed 3% of loan originations in Q320 from a standing start.

Asset-light model

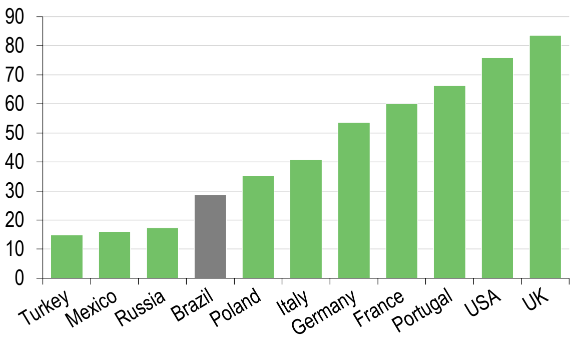
Creditas operates an asset-light model using securitisations to fund its loans more efficiently and with lower cost. The typical funding is made through various securitisation vehicles supported by fixed income investors while Creditas earns the spread. So, while the bank uses capital to acquire clients, it uses little to originate the loans themselves, which is an advantage. Creditas is investing in technology to further increase automatization and bring down the customer acquisition cost even more.

Exhibit 9: Mortgages as a % of GDP (2018)



Source: Central banks, Housing Finance Info Network

Exhibit 10: Household debt as a % of GDP (2018)



Source: Eurostat (https://ec.europa.eu/eurostat), World Bank

Revenue growth back to more than 100% pa

In August 2020 Creditas announced revenue of BRL260m in the 12 months to July 2020 and a loan book of BRL1bn. It is targeting a BRL1.6bn loan book by the end of 2020 (compared with loans of BRL600m at the end of 2019). According to the CEO in an article in *O Globo* in August 2020, Creditas was growing loans 8% per month before the pandemic, which initially slowed to 3%. He states that month-on-month growth then recovered to 5% in July and 6% in August, and he expected it to be back to 8% in September.

According to VEF, Creditas broke even in Q220. However, it is now back in faster growth mode and in loss.

In terms of competition, alongside bigger banks that are increasingly focused on digital banking, there are smaller, more-focused institutions such as Geru, Banco Bari and Banco Inter and personal credit specialists such as Crefisa. There are several players that have spotted the business opportunity and are pursuing it with a digital approach.

So far Creditas has raised US$300m in funding, of which US$55m was from VEF in December 2017 and was followed by US$231m from Japan's Softbank in July 2019 (31% stake on a US$750m valuation). This is a significant level of funding for growth. The entry of Softbank into the capital was an important boost because it provided Creditas with significant funds that allow it to scale up, which can be an important advantage in fintech. Creditas now has more than 1,600 employees. It ranks in the top three fintech firms in Brazil in terms of capital raised along with two digital banks: Nubank (backed by TCV, a US venture capital fund) and Banco Inter. We note that Softbank also invested heavily in Banco Inter. Because this bank competes with Creditas in some business lending lines, this could potentially raise some conflicts of interest.

Nibo (20.1% stake)

The Brazilian corporate tax system is complex and intricate. There are three levels of tax authorities (federal, state and municipal) and the state and municipal rules vary by region. Traditional tax forms are not unified or homogenised. There are several different taxes levied (for example, federal authorities traditionally have two on revenue alone) and the cost of compliance is high. It is time consuming, the penalties are stiff and considerable effort can be spent on litigation.

There are ongoing movements to simplify the tax system in Brazil and make compliance easier. Nevertheless, it remains a challenge especially for SMEs with smaller budgets. Nibo was founded in 2012 and is an accounting software-as-a-service (SaaS) provider, targeting SMEs in Brazil. It changes the way accountants and SMEs interact in a new faster, easier and more efficient way. It is estimated that 80% of these Brazilian SMEs do not use financial management software solutions and rely instead on physical paperwork.

Nibo has about 309,000 paying SME and 3,400 accountant clients. Nibo has a three-year CAGR of about 250% and 55% in the number of SME and accountant clients. There are 10m SME and 80,000 accounting firms in Brazil (according to the IBGE) with every SME obliged to have an accountant.

By the nature of its product, Nibo has accumulated and manages a unique pool of SME data, which allows it to offer a variety of additional financial services such as accounts, invoicing, cash flow projection tools, bill payments and so on to Brazil's underserved SMEs as a natural extension of the core products. Nibo's business model is similar to the likes of Xero, Quickbooks, Fortnox and Intuit, which have been successful in other countries. Conta Azul is a local competitor.

Nibo was breaking even when VEF invested. According to VEF, it backed Nibo to allow it to grow faster and burn some capital in doing so.

Guiabolso (10.9% stake)

Guiabolso is an online personal finance manager that enables users to better manage their bank accounts and financial products in one place and keep track of their budgets. It also allows users to compare and calculate cost savings on interest rates and fees. It is available on both iOS and Android platforms.

Guiabolso works best if a client links their bank accounts because it is then able to make useful offers over a wide range of financial products as it can use proprietary bank data-aggregation technology to have a complete view of the user's financial profile. By scrapping and aggregating data from all the accounts, their records and transactions, Guiabolso is able to have an edge on the individual banks themselves. Guiabolso is integrated with most significant Brazilian financial companies, including all five of Brazil's big financial banking groups and it is the current leader in this niche.

Guiabolso has offered its own loans in the past, but due to disappointing results through credit losses it now just offers products from its various business partners. These products include loans, credit cards, investments, digital bank accounts and insurance. Guiabolso revenue comes chiefly from the selling fees.

It has 6.1 million customer app downloads, of which more than 3.9 million have linked their bank data to Guiabolso. It is the equivalent of Credit Karma and Intuit Mint (both US) and Tink (Sweden). It is the leader in Brazil in this segment and its competition includes local players such as Organizze, Mobils and Spendee. Compared to peers, Guiabolso seems to be more automated in its platform and better integrated with various banks and financial services providers.

As well as growing its B2C business, Guiabolso is now live with its B2B account aggregation service, where it is working with one of Brazil's largest banks and insurers on a SaaS-based venture.

FinanZero (18% stake)

FinanZero is an online marketplace for consumer loans in Brazil that was launched in November 2015. It aggregates loans from its partners to find the best match for its users. Its partners include 45 banks and credit institutions. Full integration with the banks allows FinanZero to handle the whole lending process from start to finish. Besides unsecured personal loans, the platform also allows home and auto refinancing. It partners with Creditas, and is one of Creditas's lead generation and customer acquisition avenues. There are other Brazilian companies with similar business models such as Bompracredito, Emprestimosim (Sim), Serasa and eCred and we believe this is still a fragmented niche at this stage.

Revenue comes from the selling fees paid by the lenders. The loan money is usually released (once approved) within 48 hours. Fees are often around 3% of the loan (paid by the borrower) and can be as high as 10%, depending on the interest rate of the loan.

The founding team has a successful track record and experience from a leading consumer loan broker in Sweden. The key shareholders are Swedish (Webrock Ventures and Zentro Founders). Webrock has several fintech ventures in Brazil. The business model is similar to Sweden's Lendo and France's Mon-taux.

Magnetis (17.5% stake)

Magnetis is a digital investment adviser that offers automated investment portfolios tailored to its clients' requirements and was founded in 2012. It has a downloadable app compatible with iOS and Android platforms. By using proprietary robo-adviser technology, investment advice can be delivered in a cost-effective way. Magnetis has 5,000 clients and about BRL450m in assets under management.

Until a few years ago, prevailing high interest rates meant a substantial amount of money was left with a bank's asset management division or as bank deposits and was paid a fixed percentage of money market rates. Savers could obtain attractive real yields with little risk and effort. However, the SELIC (the Brazilian policy rate), which was still above 10% in the fourth quarter of 2017, is now only 2%. The long end of the curve has also come down and the Brazilian government 10-year bond that yielded 11–16% for most of the last 10 years, and was still yielding 9% in Q319, is now yielding 7%. So the yield curve is not only much lower but also sloped. At the same time, the equity market was very strong until the pandemic. Consumers are now increasingly looking more carefully at their investment options.

Wealth management to the masses

Magnetis aims to meet the growing demand for wealth management services and bring it to more people in Brazil by making these services more accessible and cheaper through technology. Clients pay a single fee for the products purchased with no further fees for advice or consulting.

The management team has extensive experience in the asset management area, with experience of investing in Brazil and in-depth knowledge of regulatory architecture and requirements in a space with limited competition. Magnetis uses Easynvest, one of the larger Brazilian digital brokers (recently purchased by Nubank, a growing digital bank), to execute the orders.

Magnetis also has a strategic partnership agreement with GPS Investimentos, a Brazilian wealth management company that is part of the Julius Baer Group, a Swiss private bank. GPS is a minority shareholder in Magnetis.

Xerpa (16% stake)

Xerpa is an HR and payroll lending platform based in Sao Paulo, Brazil. Xerpa's salary-on-demand product, Xerpay, allows employees to access their already earned wages, instantly and at any time, similar to Wagestream in the UK. Brazil has long suffered from some of the highest interest rates globally and poor financial inclusion, and 60% of workers struggle to make their paycheck last the month. Through Xerpay, employees gain instant financial security and thus can avoid the cumulative spiral of debt, defaults and penalties caused by overdraft and credit card revolvers commonly used when workers cannot access their earnings between pay cycles.

Konfio (11.4% stake)

Konfio's corporate objective is to build digital banking and software tools to boost SME growth and productivity in Mexico. It has a digital unsecured lending platform targeting Mexico's small businesses. It was founded in 2014. Small businesses are often underserviced in Mexico. Mexico is Latin America's biggest market after Brazil, with a population of 127 million and an estimated seven million SMEs (according to INEGI, the Mexican National Institute of Statistics and Geography). Of these, an estimated 10% have access to financing.

According to OECD data, the Mexican SME sector provides 74% of employment but only 32% of value added to GDP. This compares to Europe, for example, where the respective figures are 70% and 50%. A key reason for this is poor access to financing and consequent low capital intensity and productivity of the Mexican SMEs.

SME loan market potential

Konfio wants to be a participant in and agent for change. It estimates the Mexican SME loan market has the potential to increase from US$43bn (under 4% of GDP) in 2017 to over US$100bn (close to 9% of GDP) in the next few years. Of this uplift in loans, it sees US$32bn coming from a structural catch-up in lending and US$25bn through digitalisation.

Konfio's loan approval time of 10 minutes contrasts with 15–20 working days in traditional banks. The loans are offered in real time with no humans involved. The average loan size is US$12,300 and the interest rates vary from 25% for medium-sized companies, 31% for smaller businesses and 39% for business professionals. The medium-sized lending is usually secured by real estate, the rest is unsecured. Terms are 40 months for the medium-sized companies, 16 months for smaller businesses and 12 months for professionals. Overall, the above interest rates are not particularly low, but for many customers the positives are that they are available and are convenient to use. Konfio also provides revolving credit for working capital needs; these loans have interest rates ranging from 25% to 40% and are unsecured.

Konfio leverages tech, big data and recent Mexican fiscal control to offer loans to creditworthy customers historically underserved by traditional banks. The mandatory electronic invoicing (CFDI) that exists in Mexico along with Konfio's proprietary algorithm enable the company to analyse and evaluate SMEs much more quickly and efficiently than traditional banks. This algorithm looks at five broad areas: biographical data, social network data, potential, lending history and transactional data.

Konfio also offers tools though its cloud-based Kompás system to help businesses with their financial management. This includes income and expenses analysis, risk invoices alerts and billing summaries.

Another future revenue source is Konfio, through its Konfio Tech Services (KTS) division, making its open-ended technology platform available for use by other companies, including financial institutions and non-financial companies that are the centre of large supply chains and want to increase the knowledge and tracking capabilities of their relevant SME ecosystems.

It is backed by some of the strongest venture capital companies in Latin America including Softbank, which is important for future funding. We also note it has a US$100m credit facility secured by Goldman Sachs. According to Crunchbase, Konfio has raised US$403m since 2013. According to the FT, Konfio had revenue of US$12m in 2018.

Konfio is growing quickly and with strong momentum; its loan origination and revenue was 2.6–2.8x higher in Q419 than in Q418. The plan was to grow at a similarly fast pace in FY20 before the COVID-19 crisis; however, this is likely to slower.

Konfio's competition in Mexico tends to be informal lending and credit cards and there is no direct fintech competitor.

Examples of online SME lending businesses peers include Ondeck, Prosper (in the US) and Capital Float (India).

Konfio was marked down significantly at the start of the COVID-19 crisis due to concerns over asset quality, especially because most lending is unsecured. Konfio provided interest rate holidays of about one to six months for up to 50% of its portfolio due to the pandemic. The window has now closed, and the company claims that it has been successful in mitigating asset quality fallout through this period due to these interest rate holidays. Konfio had an estimated non-performing loan ratio of 5% at the end of 2019 but this is likely to be higher now.

TransferGO (15.4% stake)

Founded in 2012, TransferGO is a digital low-cost, cross-border money transfer service. It is account to account (so no face-to-face interaction is required) and available for iOS and Android platforms. Money can be sent from 32 countries to 47.

TransferGO's headquarters are in London and it is regulated by the FCA. Its key target market is transfers to Eastern Europe, often blue-collar workers sending remittances from Western Europe. Money can also be sent to several countries in Asia and Africa, including almost all larger countries. Money can also be transferred to the US and Canada, but there are no South American countries on the list.

TransferGO's geographic strength and leading position is in eastern Europe. TransferGO is the number one provider in this region for digital send/receive services with its key markets being the Baltics, Poland, Ukraine and Romania.

TransferGO has proprietary technology and infrastructure that allow it to conduct same-day transfers at very low cost, in as quickly as 30 minutes to a couple of hours. Its operations are well integrated with a network of about 30 banks, which allows some of the fastest guaranteed settlement times among peers. TransferGO reached one million customers in 2019.

In 2019, the global remittance market transferred US$670bn (according to the World Bank) with an average cross-border remittance cost of 7%. Transfers are becoming increasingly digitalised; the percentage of remittances done digitally has increased from 10% in 2014 to 36% in 2019. VEF believes it will be over 50% by 2023.

TransferGO's transaction volume grew 68% y-o-y in 2019 with a 69% increase in active users (90-day period). Revenue grew 33% y-o-y in 2019.

TransferGO charges a fixed transfer fee (starting at £0.99) plus a 0.6–1.5% charge for currency conversion. It has several transfer options including standard and express. This is a competitive industry. Competitors include large-scale, well-known operators such as Western Union and PayPal, as well as companies such as WorldRemit, TransferWise, Azimo and Venmo. Other significant players coming into this segment include Google (Google Play Send, only available in the US) and even Facebook (its Messenger app has some peer-to-peer payment functionality). We expect some banks to increase efforts in this segment. For example, Banco Santander launched PagoFX, a cross-border payments app, in the first half of 2020. The relatively low barriers to entry and the straightforward nature of the products lead us to feel payments could easily become commoditised in the long run and sustainable margins in the sector will possibly not be as high as in other areas.

Juspay (9.9% stake)

Based in Bangalore, India, and founded in 2012, Juspay is a mobile payments platform. It provides customisable, end-to-end solutions for merchants to help them manage India's various and complex web of electronic payment systems and infrastructure. It is the leading universal payment interface (UPI) for merchants in India. Its software development kit has been downloaded 200 million times, and it has a daily volume of four million transactions and US$10bn of annualised payment volume. Amazon, Uber, Ola and Flipkart are among its customers in India.

India's e-commerce business is growing strongly. India has the second-largest population in the world, and smartphone penetration is high and rising. The UPI is an instant payment system established by the Central Bank of India and has been a key driver in the fast pace of growth in online transactions in India. COVID-19 has only accelerated this growth. UPI transaction volume was a record US$1.49bn in July 2020 with 822m transactions, according to the National Payments Corp of India, double that of 12 months ago.

As was the case with Nibo, Juspay was breaking even when VEF invested but was asked to grow faster to seize the market opportunity and to burn some capital to achieve this.

International peers include PayPal and Amazon Pay.

Revo Group (25% stake)

Revo was founded in 2012 and is a Russian fintech providing 'buy now, pay later' services to merchants and is the largest company in Russia in this niche. It is expanding into Poland and Romania. Revo uses Mokka as its brand. The loans are at low (typically zero) percent interest and subsidised by the merchant in what is basically the merchant's promotional tool. This model is often seen in offline merchants in Brazil and Turkey; online examples include Affirm and Klarna in the US and Europe and Afterpay in Australia. The site also offers promotional discounts and 'hot deals'. Mokka can be downloaded as an app in both iOS and Android platforms.

Revo merchant clients operate in a wide variety of segments including clothing, electronics, jewellery and furniture and household goods. They include new, upcoming merchants as well as established ones such as Detsky Mir (Child's World), the largest children's goods retailer in Russia founded in 1957, Ozon (one of the largest Russian e-commerce platforms) and well-known international names such as Adidas. Offline, Revo's partners have a total of over 7,000 stores (and grew 31% year-on-year in FY19).

Revo also leverages its proprietary customer data to deliver personalised marketing services for merchants and works with the merchant to increase conversion and basket size. It claims that there is a 15% increase in sales conversion growth.

Its customer base is four million users. Its loan disbursements grew 56% in 2019. Revo is the only company in VEF's portfolio that is still break even and it made a profit in FY19.

Jumo (6.8% stake)

Founded in 2015, Jumo provides financial services to unbanked consumers and SMEs in Africa by partnering with banks and mobile network operators. Products include loans, savings and insurance. Its partners on the banking side include ABSA (South Africa) and Ecobank (headquartered in Togo, but it is pan-African, and with South Africa's Nedbank, IFC and Qatar National Bank as core shareholders). Telecommunications partners include Airtel (India, with an African presence), MTN (South Africa), Telenor (Norway, but with a presence in Pakistan) and Tigo (Tanzania).

Africa has a severely underbanked population with poor access to traditional bank branches. However, there is a good penetration of mobile services (according to Pew Research Center smartphone penetration is 30–35% in Ghana, Kenya and Nigeria and is only 13% in Tanzania) and this is an easier and more cost-effective way for these clients to have access to financial services. Jumo is the largest and fastest-growing mobile financial services platform in Africa and is expanding into Asia in Pakistan and India. The operational headquarters are in Cape Town, South Africa, and the active markets are Ghana, Kenya, Pakistan, Tanzania, Uganda and Zambia. Côte d'Ivoire and Nigeria are the next planned countries for expansion.

Jumo uses automation, artificial intelligence and machine learning to build credit scores and targeted financial products for people without a financial footprint. It has over 16.7 million unique customers to date and has provided over US$2bn in credit. It has 53 million interactions with customers a month. It is the first interaction with a formal financial services company for 80% of its customers. The fact that it underwrites its own risk and is unsecured places Jumo on the risker side of the spectrum among VEF's companies, along with Konfio. However, Jumo mitigates its risk by only underwriting the first five loans to build the credit profile of the customer. After that the loan is passed on to one of the financial services partners on the platform. So effectively Jumo is a marketplace with an increasing share of the loan book off the balance sheet. About 80% of its loan book sits on partner banks' balance sheets and the remaining 20% with JUMO and gradually falling over time.

Finja (20.4% stake)

Finja is a digital lending platform in Pakistan with an integrated payments ecosystem focused on the financial wellbeing of businesses and their employees. Pakistan is still in a very early stage of digitalisation with a cash-based economy. Pakistan has 170 million people and 130 million mobile users, but only 15% of adults have bank accounts. Thus, growth prospects for digital banking services are enticing.

Finja operates a payment freemium mode where basic accounts and payments are free. It uses credit, payroll and other financial add-ons to generate revenue and added value.

It has quality partners in FINCA Microfinance Bank and Descon Group, which are key to local success. The founding team has extensive experience in mobile wallets, online marketplaces and financial products in Pakistan.

Valuation methodology

By default, VEF values its investments using a marked to model approach. It usually values companies on latest transaction value during the first 12 months then moves to marked to model. This is based on an enterprise value (equity value plus net debt outstanding) multiple of revenue, benchmarked against relevant peers. VEF works with specialist valuation and generalist auditing teams at PwC to obtain the values that PwC signs off.

We are unable to publish the price to revenue multiples of the individual companies since these details are not disclosed due to competitive reasons. On an aggregate basis the VEF Q320 NAV is on a multiple of 17x 2019 revenue.

The range of multiples is quite wide among the companies and reflects varying levels of revenue growth. REVO, Konfio, Jumo and TransferGO have lower multiples, while Magnetis, Xerpa and Finja have the highest.

The Creditas revenue figure is publicly available and it was last valued on 30 September 2020 at c 23x the disclosed 12-month revenue figure to July 2020 (BRL260m, US$47m). The implied value for Creditas of US$1.05bn in VEF's H120 accounts compares with the US$750m valuation at which Softbank invested money in 2019. The revenue multiple for the portfolio ex-Creditas is 13.8x for 2019.

If there has been a relatively recent round of funding or acquisition, VEF uses this valuation for the book value. There were six companies valued this way in the FY19 accounts, with Juspay included in Q220 (it was acquired in Q120). There are natural valuation uplifts when companies go through additional rounds of raising capital and this is a driver of NAV.

COVID-19 valuation impact

As a result of the COVID-19 pandemic, in the first quarter of 2020 VEF valued six of the companies under a new 'calibration methodology'. These companies had more macro sensitivity and COVID-19 vulnerability. The new valuation reflected new risk-adjusted revenue forecasts, currency risk and lower revenue multiples. The six companies were Creditas, Konfio, TransferGO, Magnetis, FinanZero and Xerpa. With the exception of TransferGO, valuations were lower in Q120 than FY19. Exhibit 2 shows the valuation changes. Creditas was cut by 31%, Konfio by 22% and Jumo by almost 50%.

Although we do not have much insight on the valuation changes, we think it is encouraging for the company to proactively write-down these assets at the start of the crisis.

Back to usual methodology in Q320

Some companies proved relatively more resilient than initially anticipated during the lockdown. As a result, three (Creditas, TransferGO and FinanZero) were moved back to regular marking to model and their valuations increased in Q220.

In contrast, the other three companies – Konfio, Magnetis and Xerpa – all remain on a calibration methodology. We note that Konfio's business model (mostly unsecured small business lending) is inevitably quite vulnerable to economic cycles and was in fact marked down further in Q220.

However, in Q320, these three companies were also moved back to the usual marking to model and so are all now valued as such except Juspay, which is valued as a recent transaction. The asset concerns in Konfio have now diminished and the investment was revalued by 43% after two consecutive quarters of downward adjustments. The valuations of Xerpa (+9%) and Magnetis (+16%) were also raised as they transitioned back to marking to model.

Exhibit 11: Company valuation methodology

Number of companies	FY19	Q120	Q220	Q320
Marking to model (revenue multiple)	5	5	8	11
Calibration methodology	0	6	3	0
Recent/latest transaction	6	1	1	1

Source: VEF

Valuation scenarios show upside

According to S&P Capital IQ and Morgan Partners, the average trailing revenue multiple on developed market fintech mergers and acquisition deals in recent years was 7–9x for the data and analytics, banking technology and payments segments. This compares with 1.8x for traditional financial institutions. So, while the trailing 17x for VEF is higher, we expect it to decline rapidly as the expected growth rates come through due to its emerging market profile and the relatively early stage of growth of many of VEF's invested companies.

As we have mentioned earlier in the note, the revenue in the underlying companies quadrupled in just two years to 2019 according to numbers provided by VEF. Creditas (which represents 38% of VEF's NAV) has disclosed that it is back growing at monthly rates that when annualised are above 100%. It is our understanding that pre-COVID-19, the business plan was for revenue growth that would average more than 100% pa for the portfolio in aggregate in 2020 and 2021.

Although some companies like Creditas are doing very well with the lockdown, others like Konfio are having a more difficult time. In Exhibit 12 we have shown VEF's portfolio aggregate fair value to revenue multiples assuming three different revenue annual growth scenarios until 2022 – 50%, 100%, and 150%.

The Exhibit illustrates that if the targeted revenue figures are achieved then the portfolio NAV valuation to revenue multiples come down quite quickly and compare favourably with the fintech multiples mentioned above.

Exhibit 12: NAV valuation to revenue multiples with different revenue growth assumptions

	FY18	FY19	FY20e	FY21e	FY22e
Portfolio aggregate:					
150% revenue CAGR 2019–22e	33.1	17.4	7.0	2.8	1.1
100% revenue CAGR 2019–22e	33.1	17.4	8.7	4.3	2.2
50% revenue CAGR 2019–22e	33.1	17.4	11.6	7.7	5.2
Creditas (38% of portfolio NAV):					
150% revenue CAGR 2019–22e	55.7	23.1	9.2	3.7	1.5
100% revenue CAGR 2019–22e	55.7	23.1	11.5	5.8	2.9
50% revenue CAGR 2019–22e	55.7	23.1	15.4	10.3	6.8

Source: VEF, Edison Investment Research. Note: We calculate the NAV of the companies based on the fair value calculations implied by VEF's stakes in the companies.

We have also included Creditas in the table because it is the largest asset representing 38% of VEF's NAV and because the CEO of Creditas has recently confirmed that it is currently growing at a pace that could exceed 100% pa.

Delivering growth and deals are catalysts

A key aspect of VEF is that the underlying companies are not usually listed and so are marked to model or valued based on recent transactions such as funding rounds. Furthermore, for competitive purposes the companies only disclose limited information. This does inevitably reduce transparency. However, if the companies are able to deliver strong revenue this can be a catalyst for marking up these valuations and Exhibit 12 indicates that there is scope for this to happen in the shown range of assumptions. In addition to this, transactions can also drive the valuations upward. This can include asset sales, public listing or further rounds of financing. And regarding investment exits, although VEF's track record is a short one, so far it has done very well with its two sales.

Sensitivities

Valuation transparency and risks: VEF follows private equity valuation guidelines and benchmarks against peers. However, there is still higher valuation risk than for listed, liquid assets for which more operational information and metrics are published and accessible. The ongoing COVID-19 pandemic exacerbates these risks, although we note VEF did adjust the valuation of many of its investments. Furthermore, fintech has been attracting significant investor attention for some years and this has affected valuations.

Emerging and frontier risks: there is greater variability in both macro and political risk in emerging and frontier markets.

Competitive risks: many early and mid-stage tech companies end up disappointing investors and falling short of expectations. While growth opportunities do exist and are exciting, at the same it is a competitive market and market shares, profit margins and winning business models are in flux and subject to variation.

Corporate governance risk is higher in smaller, earlier-stage companies and particularly in emerging markets. We note that VEF mitigates this risk by often taking seats on the board of the companies it invests in.

Underlying companies may need cash: with the exception of Revo, VEF has indicated that its companies are currently all loss-making and this tends to be common for fintech companies at this stage of growth. We note that, with the possible exception of Magnetis and Xerpa (they combine for 5% of total NAV), VEF expects the whole portfolio to be break even in 12 to 15 months. However, some companies may need more funding to grow. Further rounds of finance often lead to higher valuations so can be a good thing. But they can be detrimental if the prospects for a company have dimmed and investors or new cash are hard to find.

We also note that VEF's shares trade on Nasdaq First North in Stockholm, which is a trading platform but not a fully regulated market.

Performance

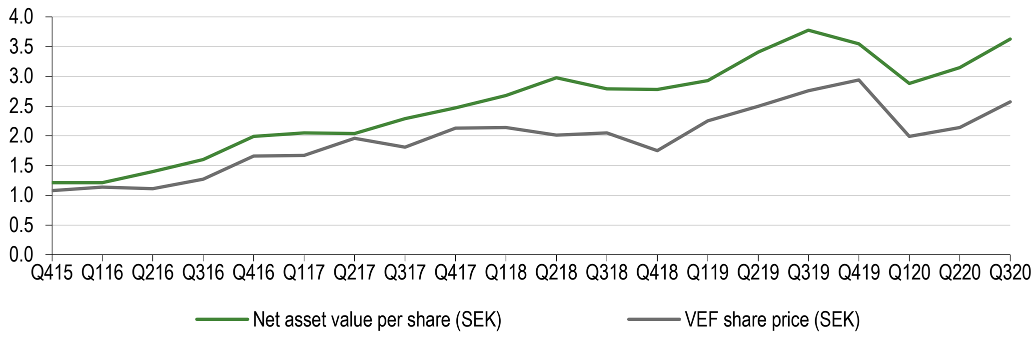
NAV has tripled since inception in 2015

Since its inception in July 2015, VEF's NAV return has tripled on a Swedish krona basis. The return has been 59% over the last three years with a 4% decline in the last 12 months. As shown in Exhibit 15, VEF has generally outperformed the emerging market world and emerging market financial indices. The MSCI emerging market tech index has performed better than VEF. VEF's significant increase in NAV was driven by the success of its first two exits, Tinkoff and Iyzico.

Q320 20% NAV increase boosts share price

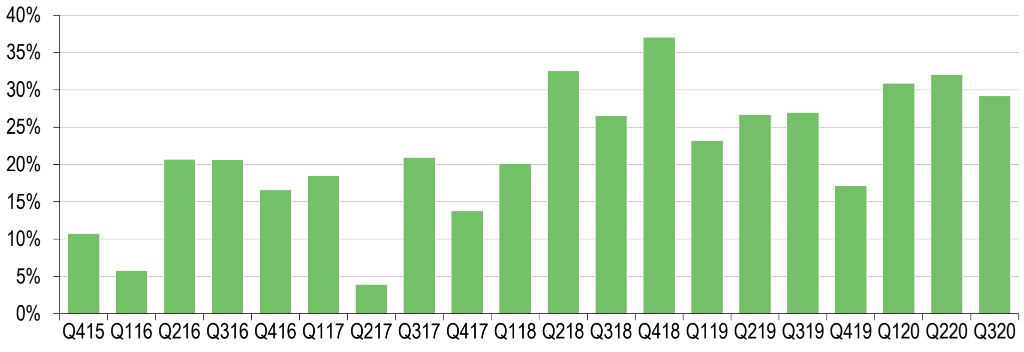
The shares have been trading at a discount to NAV of 10–35%. At the end of October 2020, VEF's shares traded at a 17% discount to Q220 NAV with a share price of SEK2.60. However, the 20% upward NAV revaluation in Q320 announced on 4 November has helped drive the share price to SEK3.15 on 5 November and a 13% discount to NAV.

Exhibit 13: VEF price and NAV (quarterly)



Source: Refinitiv, VEF

Exhibit 14: VEF quarterly discount to NAV



Source: Refinitiv, VEF

Exhibit 15: VEF total return performance relative to indices

(%)	1 month	3 months	6 months	1 year	3 years	5 years	SI
Price relative to MSCI Emerging Markets	12.5	12.0	8.1	-6.5	26.1	83.7	85.7
Price relative to MSCI World	10.0	17.1	17.5	-2.9	11.9	82.2	73.4
Price relative to MSCI EM Banks	11.3	13.1	23.2	25.6	60.6	130.2	146.7
Price relative to MSCI EM Consumer finance	9.6	9.9	-7.0	34.4	52.0	101.0	91.8
Price relative to MSCI EM Tech	12.3	5.6	-4.3	-24.1	-4.0	10.4	2.6

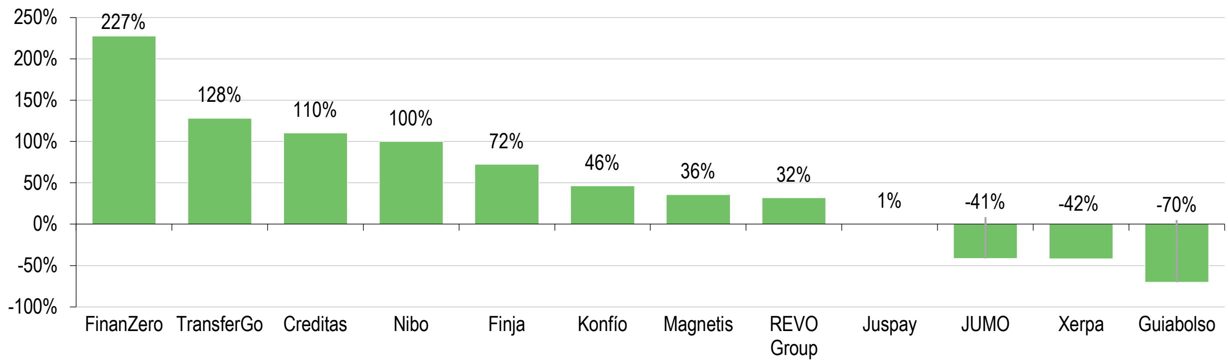
Source: Refinitiv. Note: SI is since inception (July 2015).

Exhibit 2 on page 6 details the performance of the current investments in the portfolio. In 2020, the NAV was adjusted down by 25% in Q120 due to COVID-19. The valuation then moved up by 20% in Q220 because the underlying performance of some companies (such as Creditas and TransferGO) remained strong. However, other companies after Q220 remained below their valuation at the end of 2019, including Konfio, Guiabolso, Jumo and Revo. Konfio's downgrade is due to the credit cycle as discussed in the valuation section. Guiabolso had to exit its lending business, which probably damaged its valuation. Jumo and Revo continue to grow, but, as far we understand, not at the pace that was previously expected.

Creditas and TransferGO biggest value drivers so far in 2020

The portfolio was revalued up by another 20% in Q320, with Konfio's valuation increased by 43% on the news that its loan portfolio had strengthened. Exhibit 2 shows that the net effect of the various valuation movements during the first three quarters of 2020 results in the portfolio being up by 9% ytd, equivalent to US$21m. Creditas's valuation increased by US$29m ytd in 2020, TransferGO by $13m. Konfio after the downward and then upward valuation was only down 3% ytd, equal to a $1m decline. Exhibit 16 shows the Q320 valuation compared to the amount invested.

Exhibit 16: VEF current holdings: Q320 fair value as % of amount invested



Source: VEF

Capital structure and fees

VEF can use leverage, however, it currently operates without any debt and with no management fees. The operating expenses in 2019 were 1.6% of the investment portfolio's NAV (including cash) if we exclude incentive programme expenses. This includes wages for its six full-time employees. If we include the incentive programme, the total operating expenses rise to 2.25% of the portfolio NAV in FY19.

Operating expenses ex-incentives in the first half of FY20 were slightly down 3.1% year-on-year. No incentives have been paid so far this year, so the operating expenses with incentives was sharply down 38% year-on-year in the first six months of 2020. The expenses to investment portfolio NAV was 1.7% in the six months to June 2020.

Excluding the first quarter of each year, over 2018 to 2020 operating expenses were running at 1.5% to 2.0% of NAV without incentive costs and about 1.7% to 3.0% with incentives. This does not seem expensive given that many typical venture capital and private equity companies charge 2% management fees and 20% profit sharing.

VEF's long-term incentive plans (LTIPs) initially had a three-year vesting period, but VEF decided to change the LTIP starting in 2020 (the LTIP 2020) to a five-year plan. The final reward depends on the portfolio's NAV growth. Achieving NAV three-year CAGR targets of 10%, 15% and 20%+ results in participants correspondingly receiving 2x, 5x or 10x the number of purchased shares for the base payment. With the five-year plan, the programme is proportionally higher in the first year (2020) and then decreases on a linear basis until maturity. So the pay-out on the LTIP 2020 is 10x, 15x and 35x the number of purchased shares. Under 10% NAV CAGR there is no pay-out.

Exhibit 17 shows the dilution impact of the various levels of incentive scheme pay out in the three LTIPs. If VEF were to hit the 20%+ NAV CAGR, there would be an estimated dilution of 8%.

Exhibit 17: VEF Incentive plan possible dilution

	10% NAV CAGR	15% NAV CAGR	20%+ NAV CAGR
LTIP 2018 – 3-year plan	0.23%	0.56%	1.13%
LTIP 2019 – 3-year plan	0.37%	0.94%	1.87%
LTIP 2020 – 5-year plan	1.40%	2.90%	5.00%
Total dilution	**2.00%**	**4.40%**	**8.00%**

Source: VEF

Peer group comparison

Exhibit 18 compares VEF with a fintech closed-end fund peer: Augmentum. We also show some open-ended peers even though the capital structure is different. Even when compared to Augmentum, VEF is still relatively unique. Augmentum focuses on UK and European fintech, as opposed to emerging markets.

On an NAV basis, VEF has outperformed peers in our sample over five and three years, but not in the last 12 months. We note VEF's ongoing costs are below its one closed-end peer at 1.7% of NAV in 2019. The costs are above the average of the open-ended funds, but the comparison is also affected by the greater size of some of the funds.

VEF's current gearing is zero, unlike Augmentum whose gearing is 89%. Like VEF, Augmentum does not pay a dividend, but it trades at close to NAV with a discount of under 1%.

Exhibit 18: Selected peer group at 29 September 2020*

% unless stated	Fund size ($m)	One year NAV TR (cumulat.)	Three year NAV TR (cumulat.)	Five year NAV TR (cumulat.)	Latest discount (cum fair)	Ongoing expense (ex-perform)	Perform. fee	Latest net gearing	12-month yield
VEF	**268.2**	**(4%)**	**59%**	**200%**	**(13)**	**1.7****	**Yes**	**0.0**	**0.0**
Closed end peer:									
Augmentum Fintech Ord	135.0	5.9%			(0.5)	1.9	Yes	89	0.0
Open-ended peers:									
AXA Framlington FinTech Z GBP Acc	76.7	9.1	37.9	95.9		0.87	No		0.4
BGF FinTech E2 EUR	89.9	15.7				2.32	No		
Jupiter Financial Innovt D GBP Acc	56.5	3.5	30.0	89.1		0.95	No		
Robeco FinTech I EUR	932.4	1.6				0.93	No		
Robeco New World Financial Equities I €	490.4	(5.5)	15.3			0.93	No		
Wellington FinTech N GBP Unhedged	263.5	11.6				1.10	No		

Source: Morningstar, Edison Investment Research. Notes: TR = total return. *Performance to 29 September 2020; **FY19 operating expenses without including the incentive programme. The figure is 2.25% with the incentive bonus scheme.

The board

Lars O Grönstedt is the chairman of the board of directors. He has spent most of his professional life at Handelsbanken, where he was CEO of the bank from 2001–06 and chairman from 2006–08. Today he is, among other things, senior adviser to Nord Stream, chairman of Scypho, VNV Global and East Capital Explorer, vice chairman of the Swedish National Debt Office, speaker of the elected body of representatives of Trygg Foundation and a director of the IT company Pro4U and the Institute of International Economics at Stockholm University. Lars holds a BA in languages and literature from Stockholm University and an MBA from the Stockholm School of Economics.

David Nangle is the CEO and has spent his career focusing on emerging markets and within that the financial services sectors. He was part of ING Barings Emerging Markets Research team between 2000 and 2006, after which he spent nearly 10 years with Renaissance Capital in both Moscow and London, as head of financials and research overall. He helped the firm develop and grow its financials and broader research footprint from a strong Russian base to a leading EM and frontiers franchise. Having had a front row seat in the evolution of the financial sectors across emerging markets since the late 90s, in 2015, he left the world of investment banking and co-founded VEF to back founders building the next generation of financial services firms across the emerging world.

Ranjan Tandon is founder and chairman of Libra Advisors, a New York hedge fund established in 1990, which was converted to a family office in 2012. Barron's had consistently ranked Libra – a long/short fund with a focus on domestic and emerging market equities – as one of the top-performing hedge funds across the globe. A graduate of Harvard Business School, Ranjan has a degree in chemical engineering from the Indian Institute of Technology, Kanpur, India. He has held several operating positions with DCM in India and Halliburton in Europe, was CFO of Intermarine in Texas and a financial executive with Merrill Lynch before he followed his passion for investing. Ranjan is a board member of the NYU Tandon School of Engineering (5,500 students) and the Carl Schurz Park Conservancy.

Allison Goldberg is currently a partner at Saints Capital Media Ventures, a technology and digital media fund. Prior to this, she was a partner at Advancit Capital, focusing on early stage investments in consumer and media technology companies. Previously, Ms Goldberg has served as group managing director & senior vice president of Time Warner Investments, where she ran the group focused on investing up to $25m in private companies. She was an associate at Groupe Arnault, investing in and managing new media and technology equity investments for LVMH's chairman's private holding company, and before that worked at Morgan Stanley. Ms Goldberg is a board member of FirstMark Horizon Acquisition Corp, YieldMo and Proletariat and is an advisor to Bustle

Digital Group. She has previously been a board member of or active observer on the boards of several companies including Adify, Amino Apps, Bustle Digital Group, Discord, Dynamic Signal, FanDuel, Fuse Media, iStreamPlanet, MediaVast, SambaTV, Simulmedia, Trion Worlds, and Visible World. Ms Goldberg graduated summa cum laude from the Wharton School at the University of Pennsylvania where she received a BS in economics.

Per Brilioth was head of the emerging markets section at Hagströmer & Qviberg between 1994 and 2000 and worked close to the Russian stock market for a number of years. He is a board member and the managing director of VNV Global. Other significant board assignments include member of the boards of RusForest, Tethys Oil, Avito, Svenska Fotografiska Museet, UniversoLeo and X5 Group. Per is a graduate of Stockholm University and holds a master of finance from the London Business School.

Exhibit 19: Financial summary

Year-end 31 December, US$000s	2017	2018	2019	Q120	Q220	Q320
INCOME STATEMENT						
Financial assets revaluations	7,568	6,213	53,452	(61,775)	37,703	45,196
Dividend and coupon income	79	3,022	501	97	100	97
Other income	0	0	0	0	60	12
Total operating profit	7,647	9,235	53,953	(61,678)	37,863	45,305
Operating expenses	(705)	(3,763)	(3,869)	(491)	(1,395)	(862)
Employee incentive programme	0	(1,763)	(1,737)	0	0	0
Total operating expenses	(705)	(5,526)	(5,606)	(491)	(1,395)	(862)
Operating result	6,942	3,703	48,347	(60,169)	34,468	44,443
Net interest income	0	16	73	0	(3)	(2)
FX income	115	(193)	160	11	254	4
Net financial items	115	(177)	233	11	251	2
Profit before tax	7,056	3,532	48,580	(63,158)	37,719	44,445
Taxation	0	(79)	(51)	0	(7)	(16)
Net income	**7,056**	**3,453**	**48,529**	**(62,158)**	**36,712**	**44,429**
EPS (US$)	0.01	0.01	0.07	(0.10)	0.06	0.07
Diluted EPS (US$)	0.01	0.01	0.07	(0.10)	0.06	0.07
BALANCE SHEET						
Tangible non-current assets	0	146	275	239	244	217
Equity financial assets	140,400	152,002	210,387	162,709	203,026	248,236
Liquid financial assets	0	44,896	34,521	20,849	18,047	18,033
Other financial assets	10	18	11	11	10	10
Total financial non-current assets	140,410	196,916	244,919	183,569	221,083	266,279
Cash and cash equivalents	11,972	5,479	5,562	3,150	2,545	2,141
Other current assets	20	0	0	0	124	0
Total Assets	**152,401**	**202,665**	**250,944**	**187,131**	**224,247**	**268,755**
Interest-bearing liabilities	0	0	0	0	0	0
Long-term liabilities	0	0	118	97	90	76
Other current liabilities	788	163	211	154	177	132
Tax expenses	0	0	53	0	56	59
Accrued expenses	136	1,080	1,123	452	688	314
Total liabilities	**924**	**1,243**	**1,505**	**703**	**1,011**	**581**
Shareholders' equity	**151,477**	**201,422**	**249,439**	**186,428**	**223,236**	**268,174**
CASH FLOW STATEMENT						
Result before tax	53,170	3,532	48,581	(62,159)	36,720	44,445
Result from financial assets at FV through P&L	(52,490)	(6,213)	(53,202)	61,775	(37,703)	(45,196)
Other non-cash adjustments	(4,095)	0	0	(707)	(711)	(195)
Operating cash flow	**(3,415)**	**(3,392)**	**(4,112)**	**(1,472)**	**(868)**	**(788)**
Investments in financial assets	(79,544)	(80,616)	(48,819)	(13,425)	(3,311)	0
Sales of financial assets	62,774	79,337	54,013	13,000	3,500	0
Dividend and coupon income	4,345	3,022	501	97	100	97
Interest received	1	16	73	0	0	-23
Tax paid	10	(59)	(30)	(13)	6	2
Net Investment portfolio cash flow	**(12,414)**	**1,700**	**5,738**	**(341)**	**295**	**76**
Investments in office equipment	0	(154)	46	0	0	0
Repayment of lease liabilities	0	0	0	0	(30)	(20)
Buy-back of own shares	0	(2,327)	(1,586)	(641)	0	0
Proceeds from new share issue through employee options	0	0	0	0	0	298
Other investment & financing activities	0	(2,481)	(1,540)	(641)	(30)	278
Change in cash and cash equivalents	**(15,829)**	**(4,173)**	**86**	**(2,454)**	**(603)**	**(434)**
Cash and cash equivalents at beginning of the period	24,998	9,804	5,479	5,562	3,150	2,545
Exchange gains/losses on cash and cash equivalents	635	(152)	(3)	(43)	(2)	20
Cash and cash equivalents at end of the period	9,804	5,479	5,562	3,150	2,545	2,141

Source: VEF

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Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia