Introduction:

At Manole Capital, we focus all our time on FINTECH and doing bottoms up, fundamental research on financial and technology companies. As a quick reminder, we define FINTECH as "anything utilizing technology to improve an established process."

In our normal quarterly newsletters, we provide macro commentary and discuss interest rates, inflation, trade, and Fed actions; then we touch on some items impacting our FINTECH industry. However, during this global pandemic, it is fairly easy to see interest rates staying at or near zero for quite a while, as well as limited or with no signs of inflation. While the Fed has been unbelievably active, and we will touch on some of their actions, we really wanted to highlight some of the bigger takeaways impacting our FINTECH industry. COVID-19 has fundamentally altered businesses around the world, and companies are trying to deal with unprecedented amount of volatility and uncertainty. We will attempt to lay out the case how some of our companies are actually benefiting from this challenging environment, but with this newsletter, we thought we would try something new. We have inserted a new section into our newsletter called "***What We're Watching in FINTECH.***" Some of these topics might be obscure, but we wanted to address some of the bigger trends and issues we are seeing in the FINTECH industry. We hope you enjoy our subtle shift away from macroeconomics and more towards a FINTECH specific newsletter. We'd love to hear from you, so feel free to let us know your thoughts.

A Crazy 6-Months:

2019 was wonderful for the equity market (i.e. the S&P 500), with an increase of over 31%. January started out positive too, despite some early Middle East tensions with Iran. Do you remember that? While a several hundred people died in China from an unknown virus, the US equity market was not particularly concerned. We do not want to sound flippant, but most simply did not believe COVID-19 was going to stop the record 11-year bull market we were in. The world had encountered and "beat" viruses in the past. Over the last four decades, Schwab Research studied thirteen virus outbreaks and the equity market response. They found that the MSCI World Index gained an average of +7% in the six months following each outbreak. As January came to a close, cases were just beginning to occur in other countries and the WHO (World Health Organization) declared this new coronavirus a health emergency.

With a near record 158.8 million Americans gainfully employed in February, the stock markets reached an all-time high. It wasn't just the US hitting records, as stock markets in Europe and India also peaked. By February 11th, the WHO named this virus COVID-19, but many still expected this to be a China-specific problem, not a global matter. As February continued, countries began to experience a sharp increase in cases, especially Italy, Spain and Greece.

In retrospect, it is always easy to identify peaks and troughs. When we discuss the Financial Crisis, we often cite March 9th, 2009 as the market's "bottom". However, we can boldly say that it did not feel like a market bottom at the time. Looking back a few months, we did not think we were creating a "peak" in the S&P 500 on February 19th. Within six trading days, the S&P 500 fell by (10%). By the time certain state governments started to limit travel, instruct us to socially distance, and institute stay-at-home mandates, the stock market fell by roughly (30%). Volatility happens quickly, but the market always moves just a little bit faster. While investors attempt to gauge risk in real-time (by watching tv or reading the newspaper), the stock market always looks forward. By the time the average retail investor realizes that a recession is coming or that an economic crisis is looming, it is often too late.

As we often say, “The market hates uncertainty”. Well, March brought more questions than answers. Would this health crisis ultimately lead to a market crisis? After a decade of gains, was the market about to experience an environment like the Financial Crisis in 2007 and 2008? On March 9th, the stock sell-off continued, triggering a circuit breaker and a pause in trading. With such a sharp decline and the market still somewhat panicked, it became obvious the Fed was going to have to step in. In mid-March, the Fed started by lowering interest rates back towards zero. However, a simple interest rate cut was not going to be enough. Just as it had to creatively react to the market decline during the Financial Crisis, the Fed needed to get resourceful and innovative. Before the stock market opened on March 23rd, the Fed essentially proclaimed it “would do whatever it takes” to stabilize and protect the economy. The Fed stated it would purchase an “unlimited amount” of government debt, kickstarting a new round of QE (quantitative easing). While President Trump lampooned his personally chosen Fed Chairman for months, Jerome Powell acted decisively and aggressively. Instead of just meeting market expectations for stimulus, Chairman Powell well exceeded those goals.

During the 1st quarter of 2020, the S&P 500 fell (20%). Over only 6 weeks, the market fell by (35%). However, the rebound has been equally as brisk. During the 2nd quarter of 2020, the market rose by +20%, which was the best performing quarter since 1998. With such a quick recovery, one might have expected some “green shoots” or positive economic fundamentals. However, the reality could not have been drearier. The Labor Department reported that April’s unemployment rate hit 14.7%, with a record 20.5 million suddenly out of work. This was the worst job market since the Great Depression, and it seemed to be getting worse. Certain industries like travel, restaurants, banks, and energy were in a freefall.

We often discuss how markets are anticipatory. While the fundamentals were awful and the current state of the economy was dreadful, the stock market was looking forward and attempting to frame the next few months and quarters. Even as people were forced to stay-at-home to “flatten the curve,” the market was beginning to climb. Was it due to fiscal stimulus or the Fed’s decisive actions? Instead of focusing on the current environment, the market was estimating what the recovery would look like.

The 1st half of 2020 is in the books and it was a roller coaster ride. The 2nd half of the year is opaque and still undefined. Our outlook expects a continuation of elevated volatility and uncertainty. While New York and New Jersey seem to have controlled their fight versus COVID-19 (knock on wood), other states like Arizona, California, Florida, and Texas are struggling right now. Over the next couple of months, we expect the political rhetoric to heat up. Which sectors will outperform if President Trump is re-elected versus what areas might underperform in a Biden White House? Did the stock market rally too fast, for what is still a very ambiguous environment?

Looking Forward:

With schools closed, many families (like ours) were doing jigsaw puzzles to pass the time. While we have not seen this particular puzzle (picture from the WSJ), we can appreciate its point.

From our perspective, despite the very strong stock market of late, the economy is not terribly healthy. For the market to continue to climb higher, there will likely need broader market participation (more on that subject on page four).

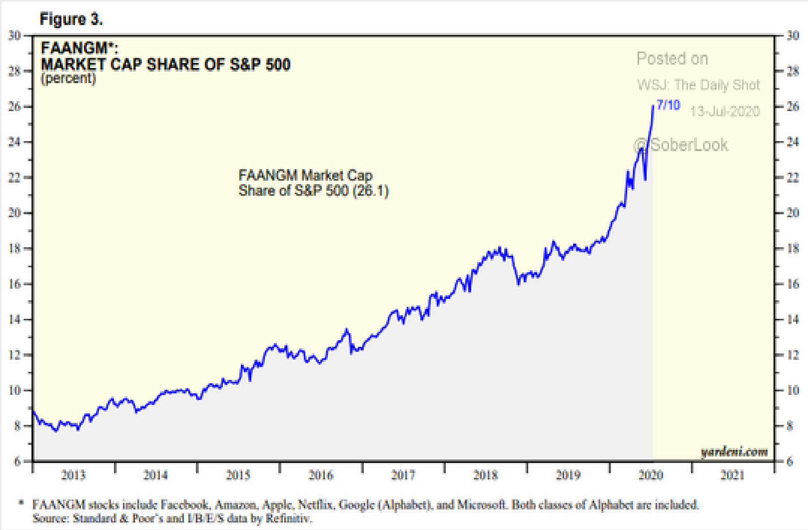
Last week, Atlanta Fed President Raphael Bostic warned that he anticipates a "bumpier road ahead," as the US economic recovery levels off and COVID-19 cases surge. Dallas Fed President Robert Kaplan echoed similar pessimistic sentiments, when he said, "with this resurgence in the disease, it's muting the rebound." We found it quite interesting when Kaplan discussed the impact of stimulus on the markets. He said, "I am a believer that we will need to get back to more unaided market function without so much intervention from the Fed. I think it's very important that the market pricing signals accurately reflect the risk, and if you don't have that, you can add distortions which may cause people to take more risks than they should."

The world is in a state of nearly unparalleled turmoil, but the stock market is about to reach another all-time high. Clearly, the market does not move up or down depending on the mood of the overall country. We are dealing with protests and civil unrest, not seen for 50 years. Washington and Beijing continue their trade spat, while also disagreeing on the future of Hong Kong. It isn't that the market is blithely unaware of this chaos, but it does tend to focus on different issues. Geopolitical tension, Middle Eastern problems, North Korean missile tests only tend to impact the market for a day or two. The stock market rebounded because of the enormous governmental stimulus, as well as the strong Fed response. To simplify the rationale for this bounce, Wall Street believes that the government rescue measures seemed to have worked and helped avoid a worst-case scenario. Rather than focusing on the awful economic data and current reported results, the market is just looking forward to that hopeful, better environment. Continuing this rally will require a return to a more "normalized" environment, within a year or so.

Not Another "Nifty 50":

Back in the early 1970s, the "Nifty Fifty" was about all investors needed to own. Over the last 50 years, these "blue chip" companies (Kodak, Texas Instruments, Xerox, Polaroid, etc) have not fared well. How were these companies perceived back then? In 1972, the forward P/E valuation for this group exceeded 100x.

Just a few years ago, all investors needed to own was FANG or Facebook, Amazon, Netflix and Google. Nowadays, it is FAANGM, which definitely is not as catchy. By adding Apple and Microsoft to this FANG group, you now have the six most important stocks in the S&P 500. The S&P 500 remains the most important US index, and it weighs companies by market capitalization. For example, companies make up more and more of the index as they get larger and larger. During the 1st half of 2020, technology stocks were far and away the best performing sector. So far this year, Amazon is up +63%, Netflix is up +51% and Apple and Microsoft are both up +29%.



As this cart shows, these six specific stocks are dominating the entire S&P 500. Yardeni Research recently published that these six stocks now equate to over 25% of the entire market

Four out of these six companies now have market capitalizations in excess of $1 trillion. Apple at a market capitalization of $1.6 trillion, Microsoft and Amazon are each at $1.5 trillion, and Google exceeds that $1.0 trillion level. The total market caps of these four companies now significantly exceeds the entire components of the London Stock Exchange.

Only two sectors of the market are positive this year: Information Technology up 15% and Consumer Discretionary up +7%. The other nine sectors are all down, with the worst performing areas being Energy (35%), Financials (24%) and Industrials (14%). Liz Ann Sonders, the Chief Investment Strategist at Charles Schwab, found that the Top 10 best-performing NASDAQ stocks have accounted for 90% of the overall index's year-to-date gains. The Top 5 of these stocks generated nearly 75% of the index's gains. She claims that this is the most concentrated positive performance of a select group of stocks in the past decade.

The 10-year average S&P 500 P/E multiple is 15.1x versus today's 22x. Skeptics say that the US stock market has not traded at this high a forward multiple since the late 1990s. The last time the S&P 500 sustained a forward P/E of over 20x was during the tech bubble. While there are pockets of the market that are absolutely overvalued (see page 12), we are still able to identify and own companies we find attractively priced. The key for us and what separates this time period from the tech bubble era is profitability. Two decades ago, many technology companies did not generate any cash flow or earnings. Fast forward 20 years to today and many of these technology companies are literally printing free cash flow.

In our last quarterly newsletter, we included a great picture from Carl Richards. We enjoy his art and the business themes he often incorporates. He recently published this Venn diagram, which we also find timely and insightful. Also, it bears a striking resemblance to the logo of one of our long-term holdings – Mastercard.

The 1st half of 2020 was unlike anything most of us have ever experienced. While things might appear to be "out of control," we will get through this difficult time period. Once again, we like the way Richards simplifies the complex and brings our focus back to what is important. It is vital to focus on items within our control, as well as those that truly matter. It is this niche or intersection that remains crucial for our investment process.

We continue to believe that secular growing FINTECH companies represents a better risk/reward tradeoff than purchasing fixed income. With 10-year US Treasuries at historically low prices of 0.65%, we find that owning equities with a forward earnings yield well in excess of 5% a wise and attractive investment decision. We remain convinced that active management and the ability to selectively purchase securities is superior to passively (and blindly) buying the entire index.

Earnings:

During 2nd quarter earnings calls (to occur in July and August), we will begin to hear how companies are handling these challenging times. The 1st quarter captured January, February and March, which was positive for the first half of the quarter and then awful for the latter half. During the 2nd quarter, most companies were experiencing a difficult and challenging period for a full three months. As companies report results, will the market focus on the most recent quarter? Will the market look forward and begin to estimate improving conditions? Is this disaster behind us, or are we about to experience a 2nd wave of infections? The news continues to focus on tests, infections, and mortality rates. However, the stock market is focused on the prospect that the worst of this crisis is behind us. The longer this drags on, the harder our recovery will ultimately be. This dynamic of current events versus forward expectations will be critical to watch and understand.

We believe the market should start to treat companies differently, based upon their recent results and (more importantly) forward expectations. In the short-term, our economy faces several speed bumps, like the expiration of certain governmental stimulus programs and stubbornly high unemployment. As the summer ends, the market will begin to focus on political dynamics and the upcoming Presidential election. Can the economy make a V-shaped recovery like the stock market has? We strongly believe that the Fed has done more than anybody could have expected or imagined. If the economy does struggle, we expect the Fed to continue to provide significant support.

At their June congressional hearings, Fed Chairman Powell and Treasury Secretary Mnuchin both pledged a willingness to provide additional relief measures, if necessary. The Fed looks to foster economic conditions that achieve its dual mandate, namely, to achieve both stable prices and maximum sustainable employment. However, it seems to be cherishing its unwritten third mandate and role as global economic backstop. As the old adage goes, "You cannot and should not fight the Fed."

Some companies have prudently managed their balance sheet, focused on free cash flow, and should come through this troubled environment bruised but fine. Others continue to struggle under burdensome debt loads and lack of prospects for growth. The market should start to separate "winners from losers," and during these times of differentiation, we feel Manole Capital excels.

Manole Capital Research:

With schools getting upended, closed and then shifted online last spring, Manole Capital agreed to bring onboard 10 new interns. This wonderful group of interns is currently studying at Lehigh University (4), the University of Tampa (3), Indiana University (1), and the University of Florida (1). We broke our interns into four distinct teams and had them conduct our 3rd annual Gen-Z financial services survey.

Why do we continuously focus on Gen-Z? Well, this "internet generation" will be critical to understand over the next few decades. The three most influential events of their lives are the September 11th terrorist attacks, the Financial Crisis and now this COVID-19 global pandemic.

Gen-Z (those born after 1995) and Millennials (born between 1980 to 1994) now exceed 20% of the US population and will make up roughly 50% of the US workforce by 2040. How will businesses engage, target and attract this group?

We received answers to our series of questions from 247 respondents. Nearly 60% of our responses were female and 40% were male. Those that answered our questions come from 28 different states and attend 33 different colleges and universities. Our target audience was Gen-Z and we successfully hit that mark as 95% were between the ages of 18 to 22 years old.

Like our prior Gen-Z surveys, this year's notes specifically target the thoughts and insights on four specific areas. We are attempting to understand how this audience will bank, conduct its payments, and invest going forward.

We published 44-pages of Gen-Z research on:

1) **Banking** (click here)
2) **Brokerage** (click here)
3) **Payments** (click here)
4) **Digital Currencies** (click here)

COVID-19's Impact On FINTECH:

In last quarter's newsletter, we spent 14 pages discussing how COVID-19 was impacting many of our FINTECH companies. For example, we were seeing significant growth in contactless cards and mobile-based payments, at the expense of paper currency. We highlighted a few parts of the transit market that are going cashless and likely will never go back.

In addition, we discussed PF's, or payment facilitators, which are employing specific practices to enable Mastercard and Visa transactions into their own proprietary software. Examples of companies we own that are capitalizing on this trend are Square, PayPal, and Stripe. Each enables customers to accept card payments without establishing a traditional merchant acquiring relationship. These entities can handle payment services for merchants that utilize their custom software, after completing a simple registration process. The key difference is that the software provider can also act as merchant acquirer, adding an unlimited number of "sub merchants" under its own account. Click here, if you would like to re-read that note.

What We're Watching in FINTECH:

In our first ever segment titled "What We're Watching in FINTECH," we wanted to discuss some timely and interesting items. We will examine industry news flow, valuations, policy announcements, potential catalysts and more. Here's a sampling of some FINTECH issues we find intriguing.

#1 Wirecard (ticker WDI):

For starters, the biggest news impact in our industry was the epic fall and ultimate bankruptcy of Wirecard, Germany's "FINTECH darling." Despite our heavy concentration in payment companies, we are pleased that Manole Capital ***never*** owned WDI.

Despite being a fairly controversial stock, WDI doubled in value in both 2017 and 2018 (identified as "A" in the graph) and reached a $35 billion valuation. This high-growth FINTECH business marketed itself as a "payment enabler," between consumers and merchants. It was widely known in the industry as a marketing whiz, that was quick to publicize its vast number of strategic partnerships. In 2019, WDI issued over 100 press releases, with many greatly overplaying the significance of that relationship.

In early 2019 (identified as "B" in the graph), the *Financial Times* reported some unusual accounting practices at WDI. Specifically, the FT published that certain WDI's foreign offices were forging and using backdated contracts. Understanding the financial statements of some payment firms can be challenging, as some have complex models with billions of small transactions from a thousands of various customers, but this was not the first time WDI was accused of wrongdoing.

There were additional allegations of irregularities, as well as reports concerning inflated revenue and earnings. BaFin is Germany's top financial supervisor and regulator (our version of the SEC). Its mandate is to probe allegations of criminal activities and its role includes ensuring that listed companies abide by securities law. Through all of these challenges, as one would expect, WDI management fiercely defended its business. WDI issued press releases claiming that these reports were "false, inaccurate, misleading and defamatory." In an attempt to clear its name, WDI hired KPMG to conduct an independent investigation into their finances.

After receiving an email from a WDI employee claiming "bullying, bribery of auditors and share-price manipulation", BaFin still did not look into the allegations. During these contentious times, instead of investigating WDI, BaFin prohibited investors from selling WDI short for two months. Eventually, KPMG investigation proved useless, as they were unable to provide clarity into WDI's finances. WDI collapsed and began to unravel in June of this year, when its primary auditors (Ernst & Young), could not find $2B of cash on its balance sheet (identified as "C" in the graph).

Despite its success as a public payments company, we never got involved in WDI. For starters, the rumors in 2019 were not the first to circulate on WDI, Back in 2010, the FBI investigated a WDI banking unit for fraud. Apparently, a German national was operating an illegal money-transfer business through WDI's banking entity. Then, in 2015, German authorities raided WDI, as they looked into additional money laundering issues. In February 2016, two anonymous individuals accused WDI of money laundering and fraud. Instead of investigating the allegations against WDI, BaFin actually opened a probe into the accusers. Three months after this anonymous dossier was published, BaFin accused 37 short sellers of market manipulation and sent reports to Munich attorneys for prosecution.

Another warning sign for us was the Nilson Report newsletter. This obscure publication is considered by payment insiders to be the industry's "bible". It is the most trusted source of payment industry information and its annual rankings are a must read (at least for us). We always found it somewhat odd that the Nilson Report never included WDI in its rankings. Apparently, it could never get comfortable with WDI's inability to breakdown its reported payment volumes, by different merchant type.

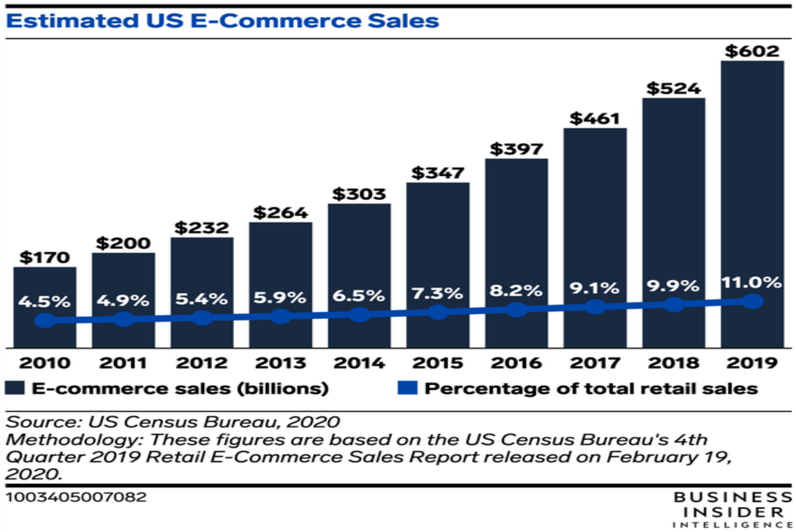
We have been covering our version of the FINTECH industry for 25 years. We focus on free cash flow and conduct bottoms up, fundamental research. Over the next decade, we imagine there will be multiple case studies done on WDI and what went wrong. Investors in WDI now have the scars of seeing an investment completely fail, like Enron. BaFin will receive a lot of blame as a blind regulator; as the auditor in charge of watching WDI, Ernst & Young will also suffer. However, the lesson is that opaque business models can be dangerous, whether they are public or private companies. Maybe we "missed" WDI because it was a German company, not a US-based entity. Maybe we never invested because of the continued noise and rumors in the marketplace. Maybe it was sheer luck? Either way, we were pleased never to have invested in this FINTECH "darling."

#2: COVID-19 Beneficiaries:

In our opinion, COVID-19 has kickstarted two major payment changes. The first opportunity occurred by mandate, with stay-at-home orders and a shelter-in-place decree. This pushed business away from physical retailers (i.e. brick and mortar) towards eCommerce. Any online purchases have to be made with a card or electronic funding source.

The second trend is the continued migration from cash and coins to digital forms of payment. We have seen a significant shift by consumers and merchants towards contactless forms of payment. In late March, the Electronic Transactions Association reported a 27% increase in contactless payments. Over the last couple of months, we believe contactless usage has continued to soar. In our last newsletter (read here), we discussed both trends. These are secular growth tailwinds, that will persist for decades. We wanted to highlight again, how these developments are impacting and benefitting our portfolio.

eCommerce continues to grow in popularity and the shift is not showing any signs of slowing down. According to a recent eCommerce report from Adobe Analytics, online shopping in March for the US and the UK increased +25% and +33% respectively. In 2000, eCommerce represented less than 1% of total US retail sales. By the end of 2019, eCommerce has eclipsed 11% and it continues to steadily climb higher. The US Census Bureau reported that in the 1st quarter of 2020, eCommerce as a percentage of US retail sales hit an all-time high of 11.8%.



In our view, shifting consumer spending patterns are likely to better insulate and benefit eCommerce payment gateway providers like PayPal's Braintree, ADYEN and Stripe. Whether this opportunity transpired because of COVID-19 or not, we believe that consumer convenience continues to point towards the secular and predictable growth of eCommerce. We believe that COVID-19 has accelerated the shift away from cash towards mobile based payments. PSCU is a credit union organization that tracks ATM and cash usage. For the week ending on May 31st, it found that ATM cash withdrawals were down 30% year-over-year. This was the 10th straight week of declining metrics for cash usage.

In our opinion, cash has a hygiene problem. Studies have been done (click here or here or here) documenting the dangerous viruses and bacteria that live on paper currency. Quite simply, nobody wants to hand a card to a cashier or touch those keypads or even a plastic stylus pens. This contact phobia has altered the payment landscape and the way consumers wish to transact. We believe it will accelerate the shift towards mobile and contactless payments.

While it is fairly easy to say that cash will continue to be the market share donor, it is still undecided which mobile based payment technology will ultimately win. Whether it is NFC or QR or some other type of technology, our payment positions are well positioned to benefit from this development. The shift towards mobile based payments has been a slow and steady process, which aligns with our view that FINTECH is more of an "evolution than revolution". Either way, the global pandemic has dramatically increased the momentum away from cash and towards contactless forms of payments.

#3 QR (quick response) vs NFC (near field communication):

The payment industry and networks (primarily Visa and Mastercard) have been pushing for NFC based applications. This technology ultimately ties back to a funding source, of either a credit or debit card. For NFC transactions to occur, one's phone or card simply needs to be placed within 6 inches of a POS (point of sale) device. As examples, both Apple Pay and Google Pay utilize NFC systems, as do most recently issued plastic cards.

QR codes (pictured here), are different and utilize a 1x, unique code to transact. QR technology is increasingly gaining traction, as it can be used by those merchants that have not bothered to update their older POS devices.

Merchants can easily install some software to their POS and then simply connect a cheap barcode reader. Afterwards, with consumers having their smartphone handy, merchants can use QR codes to process payments and launch marketing and loyalty programs.

The biggest US mobile payment success story has been Starbucks. Their payment app is an excellent example of QR based technology. Starbucks launched mobile-based payments in 2014 and it continues to dominate their checkout lines. According to data from Numerator, 61% of guests use the Starbucks mobile app. App users are 2x more likely to visit multiple times a week and 10x more likely to visit multiple times a day. Clearly, Starbucks has found that mobile based payments can help drive traffic.

Mobile payments works best, when both consumers and merchants see a tangible benefit. Consumers love the convenience of this mobile app, as purchases generate those valuable Starbucks stars. Starbucks also benefits, as it speeds up their check-out lines and lowers their transactions processing costs.

For those merchants that cannot bring the POS to the consumer (i.e. restaurants), QR codes can become a more convenient form of payment. All a consumer needs to do is scan the QR code printed on a bill using his/her mobile phone. Then, consumers will not need to hand their plastic cards (and those valuable 16-digit codes) over to a complete stranger to process in the back of the restaurant. Also, restaurants will be able to implement their sought after loyalty and marketing programs. Once again, we view this is as solution to problem and a "win win" for all involved.

Outside the US, China has been the biggest advocate for mobile payments and QR code technology. China's payment market is dominated by two entities, Alibaba's Alipay and WeChat Pay. Both use QR technology and have been quite successful with Chinese consumers. However, Chinese regulators have recently mandated that these mobile networks keep the bulk of customer funds in commercial bank accounts and that all payment transactions must be cleared through the government's platform. That kind of control occurs in China, but it will never work in the US. It is interesting that PayPal, one of our three dominant payment networks, is helping advance the use of QR codes in the US. PayPal owns Venmo, the wildly popular P2P (peer-to-peer) payment application. Within the Venmo app, consumers can now scan a QR code to help facilitate payments. Leveraging their trusted brand, PayPal might just be the next company to embrace and succeed with QR codes.

So, QR codes can become an attractive alternative to NFC usage, but this was not their original intent. QR codes were created in 1994 by Denso Corporation to help the Japanese automotive industry track inventory and parts. While using QR codes for payment applications work well, there are a few technical barriers. We will address the problems and vulnerabilities of QR codes in another note, at another time…

#4: M&A:

Lately, Visa (ticker V) and MasterCard (ticker MA) have been active on the acquisition front. In January, V purchased Plaid for $5.3 billion. In June, MA purchased Fincity for just under $1 billion. These two deals fall somewhat outside of the network's traditional competency of handling card payments. Plaid and Fincity are infrastructure plays, handling the connectivity between various financial entities. Whether it is a start-up FINTECH app or a bank or brokerage firm, these companies help "connect the pipes."

The ***Manole Fintech Fund*** purchased Plaid in December of 2018 and we described it to clients as a "financial plumber." That is probably not the description the company uses on its website or what it used to justify that $5+ billion price tag, but the analogy worked for us. There are thousands of apps being developed and many seek access to financial information or a funding source. These two companies are looking to connect, in real time, these apps to that valuable third-party financial data. Want a couple of examples? Fincity technology powers well-known apps like Quicken Loans Rocket Mortgage and credit scoring services like Experian's Boost app. Plaid has high-profile customers like P2P app Venmo, mobile trading app Robinhood, robo-advisor Betterment, and cryptocurrency exchanges like Coinbase and Gemini.

The payment networks want to expand from just processing traditional card payments into this new era of "open banking". Open banking can be described as a safe and secure way to give certain providers access to a consumers financial information. APIs (application program interfaces) are the fundamental building blocks of open banking and permit the transfer and communication between various entities in the payments ecosystem. There needs to be a set of protocols between software and network infrastructure and the payment networks want to control this process. With newly built FINTECH apps, it is important for them to connect to a consumer bank accounts. Why? Just as Slick Willie Sutton explained why he robbed banks, "[It's] because that's where the money is!" Plaid and Fincity help all types of companies build FINTECH's global trend and it is strategically important for both V and MA to become that trusted intermediary. Just as V and MA are the network or "rails" for card transactions to "run on, their goal is to become a trusted intermediary to safely connect FINTECH apps back to that prized financial information.

#5: nCino (ticker NCNO)

Over the next few months, as conditions continue to improve, a number of companies will look to raise capital and conduct an IPO. The FINTECH space remains quite attractive and nCino's (ticker NCNO) July 14th IPO is a perfect example of how "hot" this sector has become. The first-day return on NCNO was a whopping 196%. That's right! It climbed nearly 200% on its first day of trading.

Founded in 2012, and headquartered in Wilmington, North Carolina, NCNO provides cloud-based software to firms in the financial sector (i.e. banks and brokers). It operates in 10 countries and has 21 customers paying over $1 million annually for its product. NCNO has a solid customer base, which includes TD Bank, Truist Financial (the combined SunTrust Bank and B,B&T), and Santander Bank. NCNO's motto is that it was "created by bankers, for bankers" and that its software enables financial institutions to succeed in today's competitive environment. What does that mean? Well, we dove into NCNO's S-1 filing to figure out more about this new FINTECH company.

We looked at NCNO's technology and user interface; it all appears to be solid. To summarize NCNO's business, it is a single platform to help banks do loan origination and open up accounts. It is also one of more than a dozen firms that are striving to compete with Fiserv (ticker FISV), Fidelity National (ticker FIS) and Jack Henry (ticker JKHY) in the core processing business. Our analogy on the core processing business is that it is the "central nervous system" for a banks infrastructure or back office. Having covered this particular industry for over 20 years, we have come to appreciate the "stickiness" of this business. Once a bank chooses a core processing system, it is extremely hard (and unlikely) to ever replace that technology provider.

While NCNO claims to have an addressable market opportunity of $10 billion, we believe the real addressable market is much smaller. NCNO has some nice products and features, but we do not believe there is anything terribly revolutionary about their offering. At the end of April, according to its S-1 filing, NCNO had 81.6 million shares outstanding. At a first day closing price of $92 per share, NCNO had a $7.5 billion market capitalization. We do not believe this is a fair or reasonable valuation, but it seems like the retail market has become enamored with certain buzzwords like cloud computing, FINTECH and SaaS (software-as-a-service). Take a look at their website at www.ncino.com and let us know your thoughts. We simply do not believe this type of valuation is justified, considering its current or even potential future business. Could we be wrong? Absolutely! It won't be the first or last time for that…

NCNO generates no free cash flow and it is not expected to be profitable for several years, maybe not until 2023 or 2024. Over the last three fiscal years (ending January), it has experienced an increase in non-GAAP operating losses; ($15) million grew to ($19) million and was a ($20) million loss last year. Like many start-up's, NCNO reports non-GAAP earnings; it adds back the amortization of intangible assets, as well as all stock-based compensation expenses. If we add those non-cash expenses back, it would increase their operating loss by ($7.5) million last fiscal year.

Over the next several weeks, sell-side analysts will launch coverage of today's latest FINTECH "darling." We fully expect many to have raving reviews of NCNO's addressable market. We understand why NCNO decided to go public and capture this opportunity. However, from our viewpoint, there is nothing particularly enticing about this FINTECH business, especially at this lofty valuation. We run concentrated portfolios of FINTECH businesses and we plan on remaining picky on which companies we invest in. In our opinion, nCino would be better called "In-sano".

Conclusion:

At Manole Capital, we are long-term investors, taking a long-term perspective. We strive to anticipate, as opposed to react. On a daily basis, we evaluate our holdings and seek to invest in attractively priced, high-quality FINTECH companies. We continue to analyze a number of fundamental factors, regarding companies' growth prospects, cash flow, and ability to withstand a recession. During uncertain times like this, we believe our long-term investment horizon is an asset.

We don't have a crystal ball to tell us what will happen over the next few months. We are not healthcare, pharmaceutical or biotech analysts, so we cannot forecast when we will get a COVID-19 vaccine. By owning high-quality, free cash flowing FINTECH companies, we believe our portfolio(s) will continue to outperform and reward our investors over time.

In our last newsletter, we concluded with the following paragraph:

The market is starting to get attractive, but we are remaining patient and disciplined. In today's market, all stocks are being treated similarly. Once we emerge from this virus, all companies will not be on equal footing. We have our shopping list, and we are selectively buying.

While this quarterly note is three months later, we feel the same sentiment applies.

Last November, we were thrilled to meet the legendary Oprah Winfrey and listen to her give a special, 1-hour presentation. The theme of her speech was setting achievable goals and having people "find their groove."

While we have been managing client assets for over 25 years, we love that each day is different, exciting and new. We are constantly adapting and trying to get better at our craft. We feel that today's environment, of significant uncertainty and elevated volatility, is "right up our alley." As Oprah says, we feel we are really "finding our groove"!

All the best to you and your colleagues, friends, and families during this challenging and unsettling time. I look forward to speaking with you soon.

Cliff Clavin:

We decided to add a new segment to the end of our newsletters. In the 1980's, one of our favorite TV shows was ***Cheers.*** The "know-it-all" postal worker character was named Cliff Clavin, played by John Ratzenberger. This new segment highlights some useless information that Cliff would be proud of.

Gambling:

The New Jersey Division of Gaming Enforcement recently instructed its regulated sportsbooks to suspend betting on all Ukrainian table tennis events. That's right! Gamblers are so desperate that they are actually betting on Ukrainian ping pong matches. In early July, the Sports Wagering Integrity Monitoring Association alerted gaming officials that there were potential match-fixing concerns. Going forward, gambling is prohibited on all matches involving Liliia Zaitseva, Ivan Gaysin, Karen Dzhanibekyan, Eduard Panichev, Anastasia Efimova, and Gleb Zotov.

MANOLE CAPITAL MANAGEMENT

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