

KEYNOTE INTERVIEW

Leaving a legacy behind



Technology and payments are undergoing rapid shifts, creating attractive investment opportunities, say Nordic Capital's Mohit Agnihotri and Fredrik Näslund

Innovation cycles are shortening how companies develop cloud-based software and AI tools for new and often quite specific applications.

At the same time, incumbent businesses are having to move fast to keep up with more agile newer market entrants and ever-increasing regulatory demands for record keeping and reporting.

Nowhere is this more apparent than in highly regulated industries, such as financial services or healthcare, where legacy systems have historically slowed the pace of progress, and in payments, which continue to evolve rapidly, according to Nordic Capital's Fredrik Näslund, head of technology and payments, and Mohit Agnihotri, a partner focusing on technology investments at the firm.

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Q Where do you see most opportunities in the technology sector?

Fredrik Näslund: The technology sector is large and expanding, which means you need to pick the segments you know well and where you see most potential for growth. For Nordic Capital, that's making growth investments in the attractive mission-critical markets of vertical software and payments. That's because we see underlying secular growth in these areas and they don't suffer from end-market cyclicality.

There are some big trends here, too, with the payments subsector continuing to evolve as it integrates with

software, as workflow automation picks up pace, and as regulatory pressure for precision in record keeping and reporting all create opportunities. There is also a lot of demand for cloud-native software to intelligently complement and incrementally modernise complex and cumbersome legacy systems – we see this a lot in banking, where legacy systems are challenging to rip and replace.

Mohit Agnihotri: There continues to be significant investment opportunities in financial services – it is one of the largest sectors and has the greatest amount of technology spending across all sectors.

Incumbents in the industry are under significant pressure from the new fintech entrants, which is prompting

innovation and a growth cycle, and incumbents are having to update their systems to remain competitive.

Historically, keeping up would have been a massive task. Many are running on systems that are 30-40 years old and there was this promise years ago that they could just rip and replace these systems. That has turned out not to be the case because they are intricately intertwined in a highly complex enterprise IT environment, extremely mission-critical; many of the big projects have failed to deliver on that promise, despite hundreds of millions in IT spending. The transition from legacy systems will take decades and requires an incremental “hollowing out” approach.

Many of Nordic Capital’s software companies provide a different answer, as Fredrik was saying. By using new cloud native software for specific business tasks that can then be communicated with the legacy systems (for instance, tasks extracted out of legacy systems over time while still interacting with them), financial services businesses can minimise the pain of massive migrations, become as agile as the new players and generate a return on investment much more quickly. They can see the results within a couple of quarters with much lesser upfront investments and risk of large project failures.

Q Can you give any examples of this?

FN: One of Nordic Capital’s portfolio companies, Zafin, has developed software for banks that allows them to use data from other core banking systems and build dynamic products and pricing – that’s what the fintechs do, but it’s very difficult to do with legacy systems. Zafin’s software helps incumbent banks to be just as agile as these new fintechs or neo banks.

Another of the portfolio companies, ActiveViam, serves the capital market side of banks and its product helps them monitor value at risk in real time. It gives them a dynamic decision-making



Q What’s next in technology and payments?

MA: There is still a lot of innovation to come as businesses seek to do things faster and more cheaply, and consumers continue to demand better products and experiences. Technology will continue to drive productivity improvements and significant value creation. In financial services, legacy technology will continually need to be refreshed, and in payments, there will be further innovations through software applications. It’s an exciting time to be a technology and payments investor.

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FREDRIK NÄSLUND

tool that can increase profitability, for example, by warning them of a potential drop in the price of shares they hold so they can sell ahead of any fall.

Q You mentioned a move in payments to front-end software. Can you explain this?

MA: Payments have been a big growth area over the past 25 years as we’ve seen them move from cash to card and electronic payments. Now, we’re seeing newer opportunities as software is integrated with payments.

An example of this is One Inc, which builds complex software for the US insurance industry to sit on top of legacy systems. It helps unify information from the multiple systems that insurers typically have to create more efficiency. For example, for insurance claims, it can often take months for an insurer to pay out to policyholders even after the claim has been assessed and approved; by stitching together an insurer’s business systems and combining it with a payment system, One Inc can pay out within days or even within hours of approval. The insurer can benefit from this improved efficiency in a short space of time – it doesn’t need to go through the pain of replacing legacy systems. This has massive implications for the carrier’s efficiency and NPS as it simplifies the payment process.

Q What do you make of the volatility that investors in technology have experienced over recent years, and how does this affect the attractiveness of the sector?

FN: Post covid, money piled into the sector and there was clearly a bubble in valuations. That burst in 2022, while 2023 saw a stabilisation more generally, and selective stocks – such as the Magnificent 7 – rose again. It's clear that some people overpaid and there is still a lot of that story to unfold over the next few years.

Across the market, we have already seen venture capital down rounds and some bankruptcies in the sector, but there will likely be more to come. This will happen as several venture capital investments made in 2021 and 2022 mature and need more capital – the investors and founders will not be able to justify the valuations they are seeking and/or that they paid during the bubble. Yet in the mid-market growth technology space, the dynamics are different. We now see more realistic company valuations here in areas such as software and payments.

MA: What happened over the past few years was a classic technology market cycle – we've seen this before. The bar lowers and every company in the sector looks good to some investors; it's only when the market reverts to normal that the quality companies are identified versus companies that were just following the momentum. As a technology investor, you have to be disciplined during the hype stage of a cycle, knowing when to step back. We did exactly that in 2021 and 2022 because we couldn't find good assets at good prices, but the market has improved significantly since then and so we see plenty of opportunity.

Q And what about the development of AI - how is that affecting the way you look at the technology sector?

MA: In innovation cycles, you typically see people overestimate the effect of a disruptive technology in the short term and underestimate its impact over the long term – we saw this with the internet and cloud technology. With AI, it's

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MOHIT AGNIHOTRI

slightly different this time: people are still overestimating the effect in the short term, but there seems to be broad consensus of its huge impact over the long term.

It's clear that AI will fundamentally disrupt some companies – those collecting generic data or providing non-specialist automation such as reporting, for example, will be hard hit. But it will also be an enabler in many other businesses for making organisational and fundamental product improvements, especially companies that have a proprietary data advantage. Companies are deploying AI to make processes faster and more efficient, such as in coding or in automating customer relationship management.

FN: Another of Nordic Capital's portfolio companies, Inovalon in the US, demonstrates a second strong theme we see in technology businesses – using data for commercial purposes. In this case, the business is the largest owner of proprietary data in the US healthcare system, gathering information from payers, providers and pharmaceuticals

companies. It uses AI to help inform commercial decisions, while also giving patients a better quality of life. It can analyse the vast amounts of data it has to help its customers understand, for example, how efficient a drug is in treating patients.

We also have an investment in a company that automates and reduces the cost of reconciliations in financial services institutions using AI-based automation. The point about AI is that it is currently being deployed for very specific use cases.

We are also applying AI in our own firm to help inform decisions and improve back-end processes. These systems have matured quite a lot over the past year. They are not yet as precise or efficient as they could be, but they will develop further.

Q How is regulatory pressure playing into opportunities in technology?

FN: The pace of regulatory change in many industries is unrelenting – it's one of the reasons we focus on technology for regulated industries. In healthcare, financial services and insurance, regulators are looking for ever more precision in data and reporting as this becomes more possible through technological developments. These industries have to respond by using more advanced software tools because their legacy systems are often not set up to manage this level of data or precision. Investing in complementary cloud-native software is the way they can keep up and comply.

In healthtech, for example, software today provides more control over how companies conduct trials and registration of adverse events in drugs in the market. Adverse events can be easily reported in cloud-based software, from anywhere in the world, and the data collected and monitored. Previously, these processes used to be paper-based, using fax machines, so you can see how transformative the application of software and AI tools can be here. ■