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Varo Bank may run out of funds by year's end—and additional funding may not be an option

Article

The news: **Varo Bank** risks running out of funds before the end of the year, according to a regulatory filing, per Banking Dive.

Funding and burn rate: Varo was the first US neobank to obtain a banking charter from the **Office of the Comptroller of the Currency** (OCC).

- It raised **$510 million** last year and was **valued at $2.5 billion.**
- But according to the regulatory filing, by the end of March this year, Varo had **$263 million in equity and a burn rate of $84 million in the Q1 2022**. At that rate, Banking Dive estimated the bank could run out of money by the end of the year.

Varo's CEO, Colin Walsh, assured Banking Dive that the bank would not need to raise additional capital to stay afloat, stating that the figures in the report were taken out of context. He said the burn rate was a variable discretionary investment cost and that the report does not outline the full strategy for the bank.

It's not profitable: Varo used last year's funding to invest in marketing, engineering, product development, operations, and risk management. But like most neobanks, Varo has yet to turn a profit.

- The bank touted its banking charter as the reason it was able to secure $510 million financing. But **obtaining the charter took three years and cost $100 million.**
- Varo has already cut some staff, **decreasing headcount from 833 to 768** in the first quarter.
- The bank also boasted **2.7 million new accounts in 2021**, but it's **unclear how many of those accounts remain active** today, per Banking Dive.

The bank has also focused on lending as part of its push to obtain a banking charter, but according to a Banking Dive fintech analyst, the practice has not been a revenue generator.

- Like other neobanks, **Varo generates 98% of its revenue from interchange and fee income.**

Neobanks struggle to become profitable: Varo's struggle for profitability is common within the neobank space.

- Neobanks struggle to turn a profit, with an estimated **less than 5% of them breaking even**, per a report from Simon-Kucher & Partners.
- A survey of 25 of the biggest neobanks revealed that **only two of them reached profitability**. Most earn **less than $30 in revenue per customer annually.**

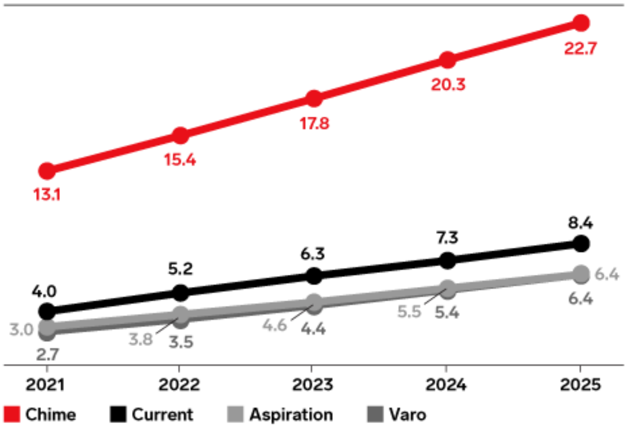
Our roadmap to profitability highlights some actions that neobanks can take to work toward profitability, such as engaging in partnerships to offer more services and boosting premium account usage. Varo claims its investments are in line with its strategy and goals, but its lack of transparency makes it difficult to judge if it's headed in the right direction.

Another round of funding? If Varo's plans for profitability fail to materialize, the bank may attempt another round of funding. But fintech analyst Jason Mikula suggests a new cash raise would be difficult.

- "Based on Varo's approximately $22.5 million in revenue in Q1, a 5x multiple would value the company at around $450 million," he wrote, adding the drop from its last round would be consistent with what other firms are experiencing in the current environment. He concluded that Varo is "in an incredibly weak position to negotiate a fresh round of funding."

What's next for Varo? Despite its CEO's assurances, without a profit and without investors, Varo will face big challenges. Neobanks are still relatively new, but the market is already looking a bit saturated. As the first neobank granted a banking charter by the OCC, Varo has a prominent position and competitive advantage in the US neobank space. Any difficulties it faces will hurt the credibility of neobanks globally.

US Neobank Account Holders, by Company, 2021-2025
millions



Note: individuals who hold at least one account at an independent, digitally native, digital-only bank that has either a banking license or operates on a licensed bank's platform (such as Chime or Varo in the US, Monzo in the UK, and Koho in Canada); account holders are not mutually exclusive; there is overlap between groups
Source: Insider Intelligence, May 2021

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