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Global Financial Services Industry: M&A and Capital Market Landscape Q3 2022 Review

Global Financial Services Market 2022: Turbulent times ahead

The M&A markets underwent a significant change in the first nine months of 2022 as the world economy continues to struggle to recover from the effects of a protracted epidemic. The effects of rising interest rates, inflation, and, more recently, a sharp decline in corporation valuation are all having an impact on the global economy. It should be observed, nevertheless, that the deal volume from the prior year did not produce a straightforward figure that could be easily repeated. Therefore, as economic, and geopolitical volatility takes its toll, businesses appear to have started concentrating on concluding the correct deals to support strategic growth and capital returns rather than expanding the volume of deals.

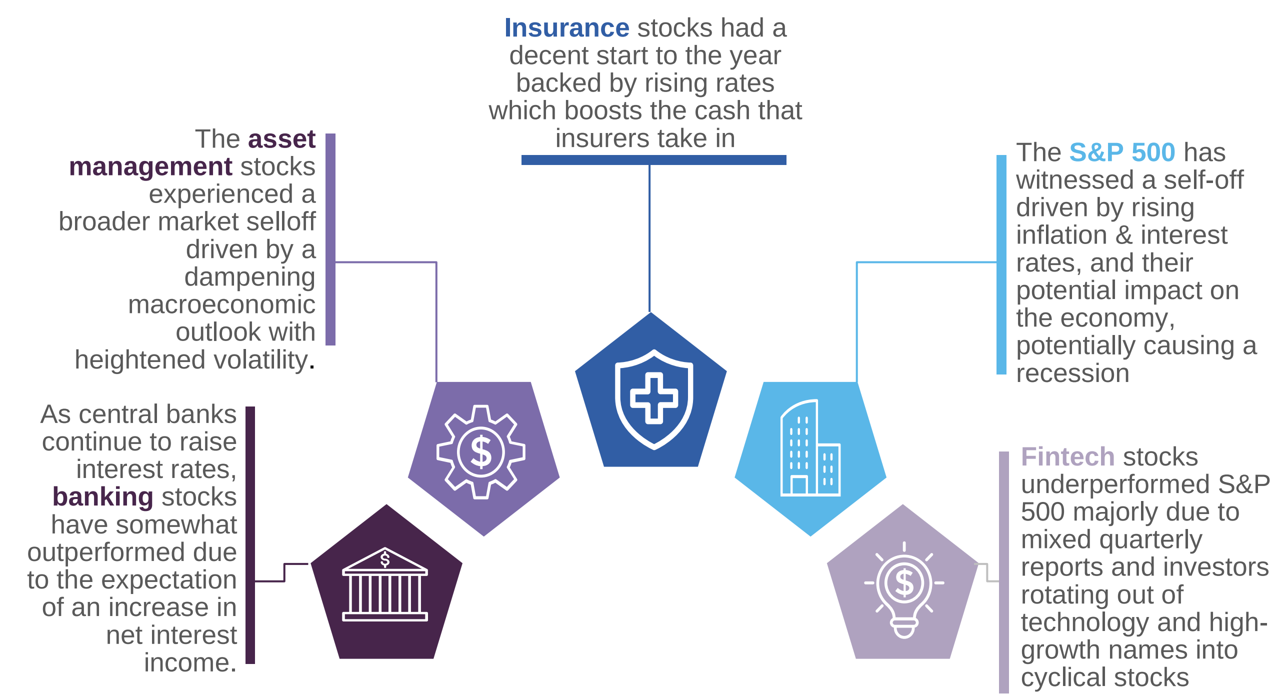
Inflation and geopolitical uncertainty are currently having an impact on decision-making, suggesting that the remainder of 2022 may prove to be difficult for the global financial services sector in terms of M&A and capital market activity. However, investors have expressed concerns about a possible recession, which might increase defaults and stimulate activity across the sector.

The global financial services industry is under tremendous pressure and is transforming rapidly due to the rise of disruptors such as fintech platforms and a more stringent regulatory environment.

The following key developments are expected to have a strong bearing on M&A and capital market activity across the global financial services market going forward:

- Global political instability, which has led to historic inflation and global economic uncertainty
- Dampened valuations and higher financing costs have reduced investors' interest in taking risky bets
- Divestitures of non-core assets may occur as businesses attempt to strengthen their balance sheets and make their business models more resilient
- Financial sponsors have largely been cautious to deploy their “eager capital”

Sector Wise Performance (YTD 2022)



Source: The sectoral analysis reflects the general performance of the respective S&P indices

Shockwaves from the geo-political crisis and tightening of financial conditions have tested the Financial System’s resilience with only the Insurance sector garnering investors’ demand aided by the rising interest rates

Key Sectoral Performance: Tale of 4 Key Sub-Sectors

Banking

- Globally, central banks have embarked on an urgent tightening cycle to combat the prospects of "stagflation," thereby signaling to the market that they are more concerned about inflation than stalling growth.
- Big-ticket North American deals will most likely find it difficult to obtain regulatory permission in the US, but mid-tier and community banks should find it easier.
- Given the difficulties involved in international deals, Europe should majorly see domestic deals with a view to building local champions.

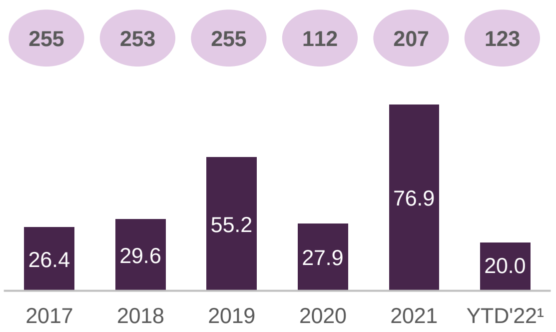


Figure: Count and Value of US Banks' M&A Deals (in US$bn)

Note: As of October 10, 2022

Asset Management

- The asset management sector is experiencing a turning point whereby wealth managers are attempting to restructure their business models to create a business that is safe, scalable, and cost-effective.
- Traditional active managers are expected to collaborate to scale up to fund new capabilities (such as ESG) and boost distribution.
- During Q3'22, the financial sector's biggest transactions were in insurance. Exor, a privately held company owned by the Agnelli Family, concluded its sale of Partner Re, a major provider of reinsurance, to a French mutual insurer Covea for US$9.3bn.
- A total of 288 asset management deals took place in 3Q'22 compared to 324 deals in 3Q'21 (as per Refinitiv). The outlook for deal-making remains strong in the remaining part of 2022, driven by consolidation, focus on gaining credit, exposure to other asset classes, and robo advisory.

Insurance

- The ongoing demand for digitalization (Insurtech) and the divestment of non-core assets should continue to drive M&A. Also, US-based buyers are continuing with their approach of making acquisitions in Europe to expand their footprint in the niche and under-tapped insurance markets.
- There are rising collaborations amongst insurance providers as well as third-party vendors in a bid to facilitate portfolio expansion. Group insurers may also consider developing "as-a-service" solutions as a potential competitive edge.
- As per S&P Global, a total of 317 insurance deals were announced during 3Q'22, compared with 255 for the same period last year. Also, a total of 27 P&C and 14 Life & Health deals took place in 3Q'22 compared to 25 and 13 deals respectively, same period last year.

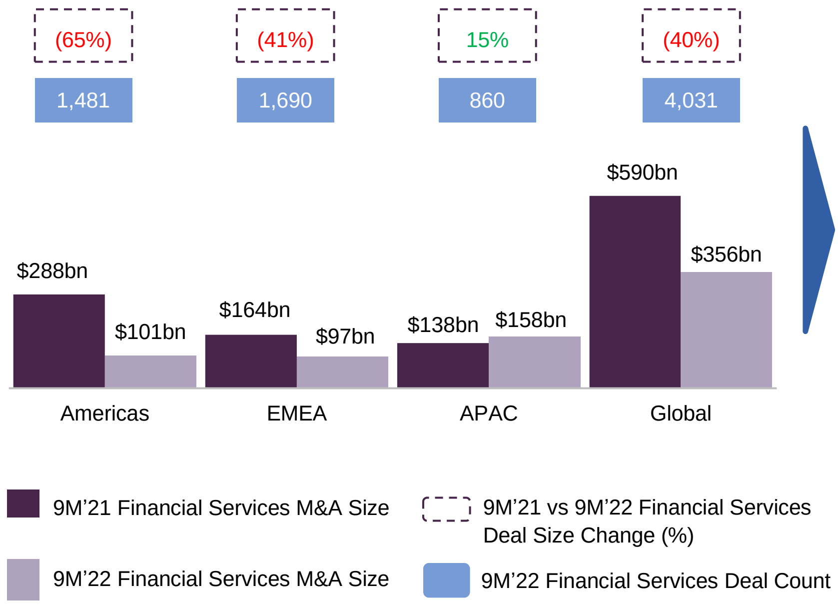
Fintech

- Fintech deal activity dropped to its lowest point in the past two years in 3Q'22 due to rising inflation, high interest rates, concerns about a possible recession, and sustained global economic uncertainty.
- There was limited activity on the fundraising side, while the IPO market has slowed down severely, and numerous scheduled SPAC mergers are getting canceled.
- Looking at the numbers the Global fintech funding witnessed a sharp drop of 38% QoQ in 3Q'22 to US $12.9bn, matching 4Q'20 levels (CB Insights). The total M&A deal count was 707 in 9M'22, compared with 789 for the same period last year. The largest deals announced during YTD'22 were ICE acquiring BlackKnight for US $16bn and Global Payments acquiring Evo Payments for US $4bn.

Global Financial Services M&A 2022: Growing concerns for businesses

The first nine months of 2022 saw muted deal activity compared to the blockbuster volumes in 2021. Governments across the globe have started hiking interest rates, which in turn has increased the cost of capital. Additionally, supply chain problems have grown due to trade restrictions and high geopolitical tensions have hastened the rejection of globalism and cross-border transactions. Investors were primarily forced to hold off on deal-making because of the uncertainty regarding the global growth outlook.

The industry witnessed limited deal closures and is yet to see the conclusion of some “big ticket” deals. The volume of deals withdrawn to date is comparable to that at the onset of the pandemic. As a result, dealmakers are having to amend their strategies to bridge the valuation gaps. They are conducting deeper analyses of the targets, thereby extending the duration of negotiations and due diligence.



The Americas and EMEA continued to experience a significant fall in M&A volumes due to a dearth of "big ticket" transactions, while the APAC region has had consistent growth given the area's relatively stronger economic circumstances since the year's beginning.

The merger between HDFC Bank and HDFC worth US$60.4bn was the largest deal announced in 2022 in YTD’22

Source: Refinitiv. Figures in US$bn. Data as of September 30, 2022.

Some key observations during 3Q’22:

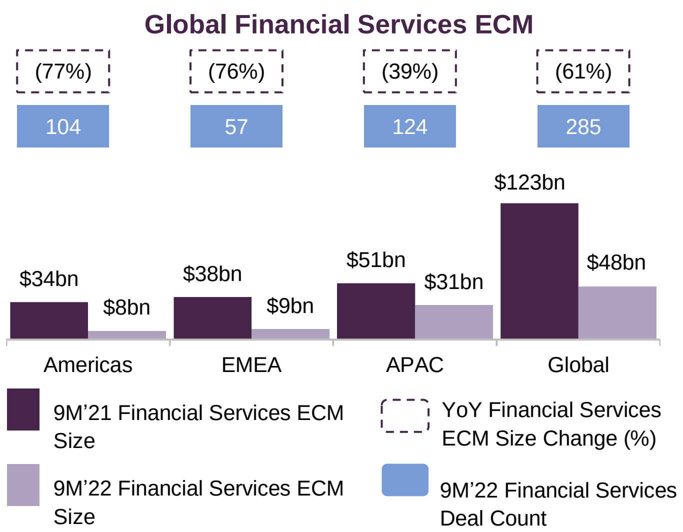
- The quickly shifting interest rate environment is making it more difficult to close deals, and it even has an impact on agreements that were made before the Fed's aggressive rate moves.
- Strong dollar gains will probably encourage local investors to invest abroad, and other companies may think about cross-border M&A to prevent target pricing from being adversely impacted by currency swings.

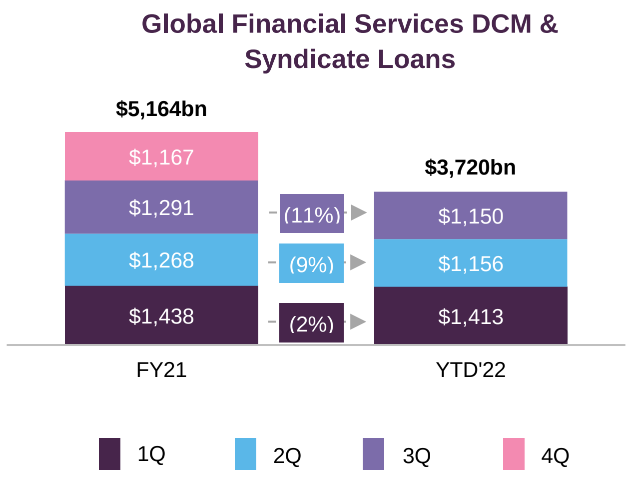
Key M&A Themes

Diversified revenue streams	Innovative solutions	Value generation	Accelerated Digitization
Strong ownership structure	High regional partnerships	Fintech Wave	Resilient cash flow

Financial Services Funding: Geopolitics and Volatility Curbing Demand

The financial equity and debt capital markets (ECM and DCM) witnessed contrasting demand this year. In 1Q'22, the DCM witnessed borrowers rushing to refinance and extend debt maturities before the potential rate hikes later in the year. However, the momentum was short-lived, with volumes reverting to pre-pandemic levels as seen by the 61% fall in the global ECM size in 9M'22. The syndicated loans market almost came to a halt due to the geopolitical crisis, with investors pausing to review their portfolios and the related primary and secondary risks. High inflation and rising interest rates are also having a negative impact on the global equity market, and as 2022 draws to a close, all these factors are creating challenges for companies to raise equity. While difficult market conditions in EMEA continue to close IPO windows, the Americas' IPO pipelines are waiting for the market to reopen next year. Although APAC has not seen an increase in IPO applications, activity is still high as companies plan for 2023.

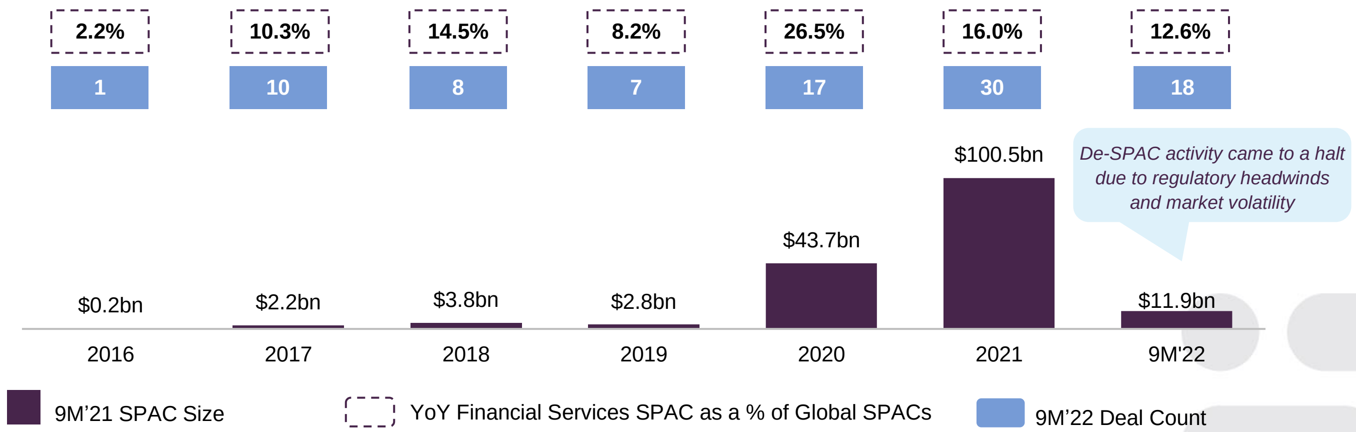




Source: Refinitiv data as of October 06, 2022. Figures in US$bn; ECM=Equity Capital Market, DCM=Debt Capital Market

Financial Services SPACs: Deal Innovation to Counter Regulatory Headwinds

The heightened regulatory scrutiny has put the brakes on SPAC IPOs. In March 2022, the Securities and Exchange Commission (SEC) of the U.S. proposed new rules and amendments to enhance disclosure and investor protections in SPAC IPOs and business combination transactions between shell companies, such as SPACs and private operating companies. Along with concerns around mixed post-deal performance, rising redemptions during De-SPAC, a weak PIPE market, and overcrowding, this has resulted in growing investors' doubts about SPACs' ability to deliver high-quality companies. Though funding has dried up this year, innovative deal structures can still revive investor faith and stability.



Source: Eikon Refinitv. Figures in US$bn. Data as of 9M'22 ending September 30, 2022.

ESG: Key to long-term and sustainable value generation

The COVID-19 pandemic has demonstrated that adhering to ESG factors is key to crisis-resilient long-term value creation. Companies with dynamic business cultures were relatively more resilient during the shutdowns, given their ability to absorb the shock. Globally, investors have started to recognize the potential benefits of announcing an acquisition that is ESG accretive.

As the ESG investment market continues to grow rapidly, Banks are strategically deploying fintech ecosystems to drive sustainability in their products and operations which is referred to as "Sustainable Digital Finance." Several banks have joined the UN-convened Net-Zero Banking Alliance. Under this, they have committed to aligning their lending and investment portfolios with net-zero emissions by 2050.

One-fifth of retail banks plan to considerably raise their ESG spending, according to a BCG analysis. Sustainability is now more important than ever to all parties involved, making it the retail banks' future competitive advantage and the basis for long-term growth. Retail banks could make significant revenues from ESG-related products while also encouraging their clientele to adopt sustainable behaviors.

From a funding standpoint, the cost of capital for companies with better ESG scores is lower than for companies with weaker scores. For instance, there is higher investor demand and better pricing for issuers for many green, social, or sustainable bonds in comparison to traditional non-ESG issuances

Outlook: Spotlight on Adaptability and Rebuild

Despite the recent slowdown, the long-term fundamental M&A themes remain intact. We foresee the following trends to define the overall deal-making in the coming quarters:

1. **Macroeconomic Tensions**: Although global M&A started the year off well, it is now challenging to ignore the worsening macroeconomic issues. The implementation of higher interest rates by central banks to restrain the rise in prices will result in more expensive financing for agreements, and further declines in corporate cash holdings will reduce the amount of money available for acquisitions.

2. **Regulatory Environment:** The global regulatory and tax conditions have been favorable though authorities have started enhancing scrutiny for megadeals. This increased due diligence will likely slow down the execution process, e.g., work-from-home compliance, cybersecurity, privacy, data protection, and accounting regulations.

3. **Technological Changes:** Digital transformation is necessary for fraud management, cybersecurity, and digital client servicing. M&A remains the quickest way for organizations to build these capabilities. As a result, technology is set to remain at the forefront of corporate strategies to build market position, especially in the current Fintech wave.

4. **Private Equity Support:** A considerable buildup of dry powder has occurred in the sector because of a decline in PE funding activity in the first nine months of 2022. There has been an increasing amount of speculation that the PE firms may try to invest a sizable amount of capital before year-end, as some investors see the current scenario as a purchasing opportunity. It is projected that competition for key technologies, ESG objectives, supply chain resilience, and recession-proof industry deals will drive deal-making through 2023 as businesses navigate the current market volatility and become ready for long-term development.

5. **Evolving sectoral dynamics:** Themes such as the rise of domestic champions, challenger bank M&A, focus on deleveraging balance sheets and reconfiguration of operating models should continue to play out

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