EVALUESERVE

Global Financial Services Industry: M&A and Capital Market Landscape FY22 Review

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Global Financial Services Market 2022: Challenging to say the least

The global financial services market underwent a significant change in 2022 as the world economy struggled to recover from the effects of a protracted epidemic. However, the deal volume from 2021 did not produce a straightforward figure that could be easily repeated. Therefore, as economic and geopolitical volatility took its toll, businesses appeared to have started concentrating on concluding the correct deals to support strategic growth and capital returns rather than expanding the volume of deals.

Dealmakers faced severe hurdles from the present uncertain macroeconomic market environment, which included slower GDP growth, inflation, rising interest rates, geopolitical tensions, and the aftermath of cryptocurrency failures. Additionally, supply chain disruptions, which affect the FS business indirectly, competition for highly skilled labor, and demand-accelerated digital and cloud transformation posed a new set of challenges for value generation.

Inflation and geopolitical uncertainty are currently impacting decision-making, suggesting that the remainder of 2022 may 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 following key developments had a strong bearing on M&A and Capital markets' activities across the global financial services market:

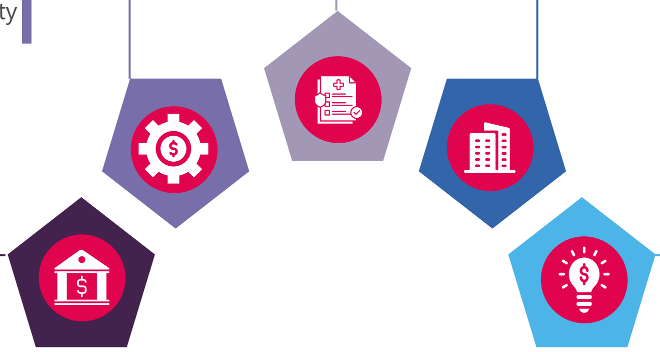
- Global political instability, which has led to historic inflation and global economic uncertainty
- Dampened valuations and higher financing costs reduced investors' interest in taking risky bets
- Spotlight on divestitures of non-core assets as businesses attempted to strengthen their balance sheets and make their business models more resilient
- Financial sponsors' cautious approach to deploying their "eager capital"
- More stringent regulatory approval process ensured there were lesser mega deals
- Though pricing improved in the second half of the year, rapidly rising interest rates created a material impact for banks that have meaningful security portfolios and created challenges for buyers

Sector Wise Performance (2022)

Insurance stocks became the only sector that ended the year with positive returns, backed by rising rates which boosted the cash that insurers take in

The **asset management** stocks experienced a broader market selloff driven by a dampening macroeconomic outlook with heightened volatility

The **S&P 500** witnessed a self-off driven by rising inflation & interest rates and their potential impact on the economy, potentially causing a recession



As central banks continue to raise interest rates, **banking** stocks have somewhat outperformed due to the expectation of an increase in net interest income

Fintech stocks underperformed S&P 500 majorly due to weak earnings and investors rotating out of technology and high-growth names into cyclical stocks

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 and a 'sticky' inflation

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.
- Larger banks are typically avoiding deals to acquire other banks in favor of focusing on acquisitions to improve their fee product offerings, which will be subject to less regulatory review.
- The housing and auto loan markets increased regulatory scrutiny of fees, and data security are all possible threats that banks may have to

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.
- A total of 370 asset management deals took place in FY22 compared to 465 deals in FY'21 (Refinitiv). The outlook for deal-making remains strong going ahead in 2023, driven by consolidation, focus on gaining credit,

contend with. In the longer term, there will be a need to develop creative new ESG, embedded finance, and digital asset applications.

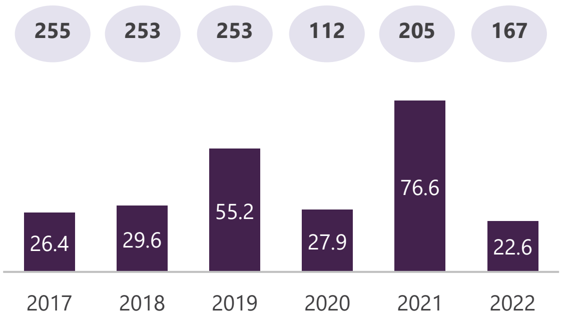


Figure: Count and Value of US Banks' M&A Deals (in US $bn)

exposure to other asset classes, and robo-advisory.

- Looking ahead, 2023 is expected to witness a continuation of M&A activity due to pressure on returns, market conditions having an influence on margins and profitability, and scale and consolidation being considered as essential solutions.

Insurance

- InsurTech continues to be appealing to acquirors looking for tangible value. Investments are anticipated to become considerably more deliberate in 2023 as opposed to being motivated by fear of missing out. Surviving InsurTechs will be more mature, offering purchasers greater technology at reasonable valuations.
- 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, Total of 790 insurance deals were announced in FY'22, compared with 1,134 in FY'21. Also, a total of 61 P&C and 30 Life & Health deals took place in FY'22 compared to 81 and 62 deals respectively, same period last year.

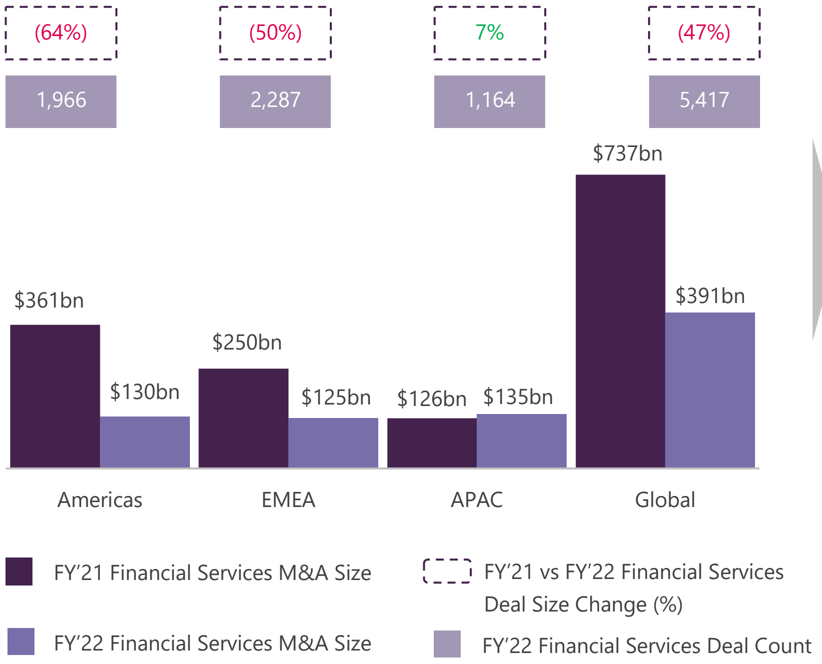
Fintech

- Fintech deal activity dropped heavily in FY22 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.
- The Global fintech funding witnessed a sharp drop of 46% YoY in FY22 to US $75bn, but up 52% compared to FY20 (CB Insights). Overall, deals fell 8% YoY to reached 5,048 in 2022. Africa was the only major region to see deals increase compared to FY21. The largest strategic deals announced during FY'22 was ICE acquiring BlackKnight for US $16bn and Global Payments US $4bn acquisition of Evo Payments.

Global Financial Services M&A 2022: Dent on investors sentiment

The year 2022 saw muted deal activity compared to the blockbuster volumes in 2021. Governments across the globe started hiking interest rates, which in turn 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 drop in ticket size was higher than the decline in activity, owing in part to a 75% decrease in megadeals (transactions worth more than $5bn) between 2021 and 2022, falling from 21 to 5. As a result, dealmakers are having to amend their strategies to bridge the valuation gaps. While the M&A market is expected to remain challenging in 2023, the FS sector is expected to provide dealmakers with numerous opportunities to execute on their strategic objectives, yet in a more disciplined and cautious manner.



Source: Refinitiv. Figures in US $bn. Data as of December 31, 2022.

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 had consistent growth given the area's relatively stronger economic circumstances.

The merger between HDFC Bank and HDFC worth US $60.4bn was the largest deal announced in 2022 in FY22

Some of the key observation during FY'22:

- The increase in interest rates in June 2022 marked a fresh stage in the capital superabundance period. The Fed's decision to raise rates in response to rising inflation happened sooner than many had anticipated. The consequences were felt globally as other central banks jumped on the bandwagon.
- In addition to interest rate uncertainty, acquirers had to deal with numerous other external concerns. For both strategic acquirers and targets, preconceptions about the fundamental business trajectories were questioned by inflation, geopolitical tensions, and the oncoming recessionary climate.

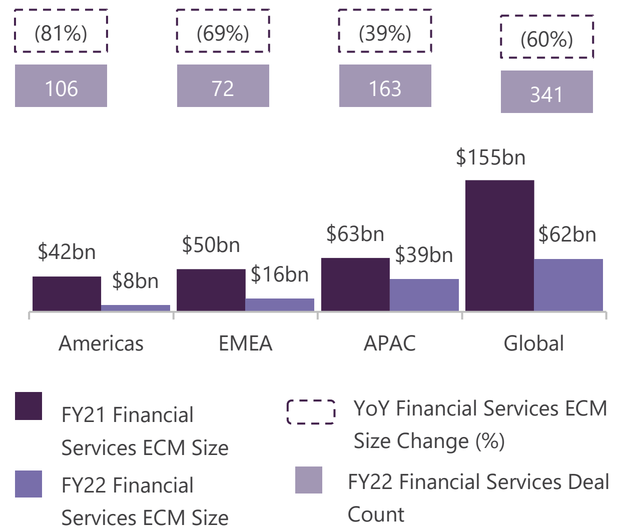
Key M&A Themes

Diversified revenue streams	Innovative solutions	Boosting shareholder's return	Accelerated Digitization
Increasing market share	High regional partnerships	Fintech Wave	Resilient cash flow

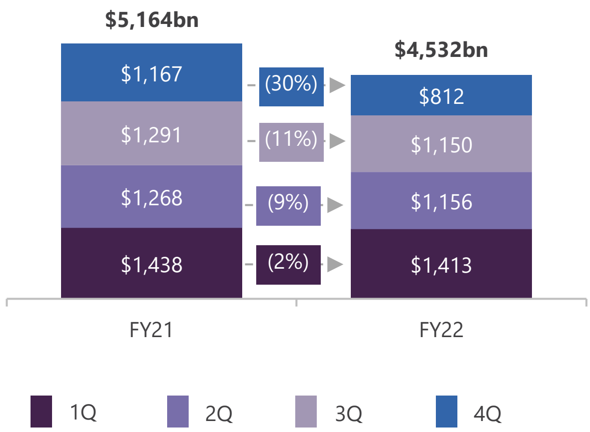
Financial Services Funding: Geopolitics and Volatility Curbing Demand

The financial equity and debt capital markets (ECM and DCM) witnessed contrasting demand this year. During the start of 2022, 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 60% fall in the global ECM size in FY22. 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 we enter 2023, all these factors are might still create challenges for companies to raise equity. A return to a robust IPO market is highly doubtful until investors as well as businesses feel confident that the macroeconomic and geopolitical backdrop will improve over the near term, while the debt capital markets are expected to be active in the beginning of the first quarter of the year as low valuations should encourage deal making.

Global Financial Services ECM



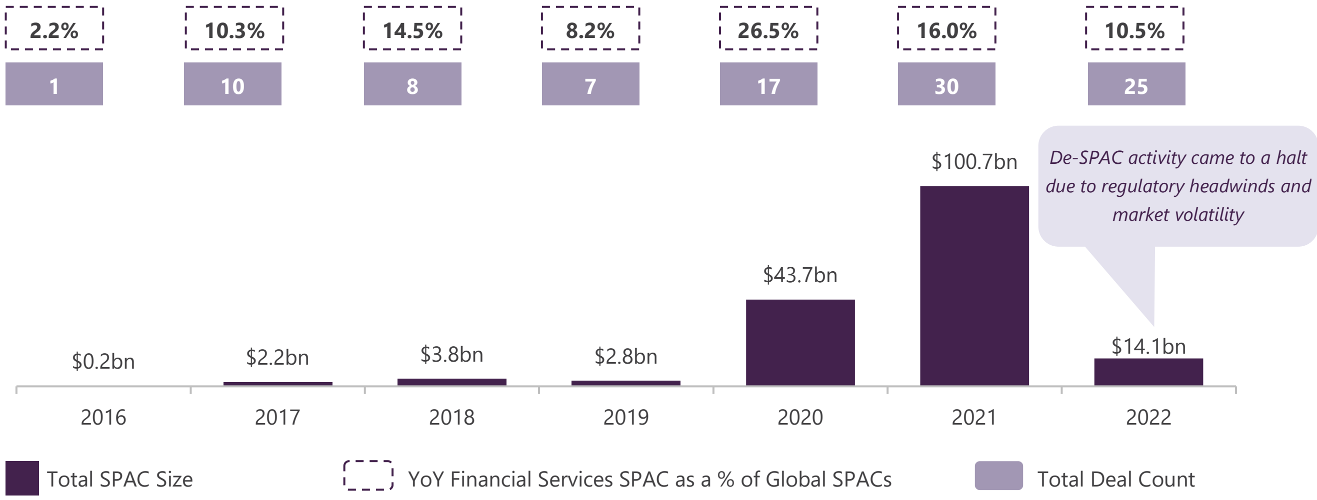
Global Financial Services DCM & Syndicate Loans



Source: Refinitiv data as of December 15, 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 SEC regulations, poor SPAC post-IPO performance, and issues obtaining PIPE finance have all contributed to rising redemption rates, lesser de-SPAC merger activity, and the cancellation of several previously negotiated SPAC agreements. Despite the slowing pace of new SPAC offerings, there are still a large number of existing SPACs looking for a target, many of which are under time pressure to close a deal soon, and there is still optimism that innovative deal structures will restore investor confidence and stability.



Source: Eikon Refinitiv. Figures in US $bn. Data as of FY22 ending December 31, 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 recognise the potential benefits of announcing an acquisition that is ESG accretive.

Global financial regulators have identified scenario analysis as a potentially useful means of evaluating and managing financial institutions' exposure to climate-related financial risks. Regulators in the US have begun to investigate how to use scenario analysis to better evaluate the long-term, climate-related financial risks that financial institutions face, as well as how these risks may emerge and vary from past events.

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 align their lending and investment portfolios with net-zero emissions by 2050.

As of 2022, more than ten US states had enacted or proposed "anti-ESG" legislation aimed at limiting financial institutions' and other companies' consideration of ESG factors. In addition to anti-ESG legislation, some states in the United States have opposed net zero alliances such as the Net-Zero Banking Alliance (NZBA) and the Net Zero Asset Managers Initiative (NZAM). Further, financial institutions that are members of net-zero alliances could perhaps consider potential U.S. antitrust scrutiny as well.

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

2023 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 2023:

1. **Consolidation:** The development of platforms and integrated finance solutions, along with shifting customer demands and escalating competition, are all examples of how traditional business models are being disrupted. Size of business is essential for creating a feasible business model and opens more opportunities for consolidation, particularly in the more fragmented markets where players must realign themselves to take advantage of economies of scale and scope.
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:** Despite the slowdown in the economy, digitalization remains a top strategic priority for banks and other financial institutions as they work to meet rising consumer expectations and operational complexity while attempting to strengthen their market positions. In 2023, it's anticipated that M&A and strategic alliances will be focused on transactions that will leverage data, address growing cybersecurity concerns, drive operational efficiencies, and speed up transaction processes.
4. **Private Equity Support:** A considerable buildup of dry powder occurred in the sector because of a decline in PE funding activity in 2022. There has been an increasing amount of speculation that the PE firms will invest a sizable amount of capital in 2023, 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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