EVALUESERVE

Global Financial Services Industry: M&A and Capital Market Landscape Q3'23 Review

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Global Financial Services Market Q3’23: Risks Remain High

The year has been a tough one for the entire financial services industry. Given that core inflation is still stubbornly high with marginal decline in many advanced economies, central banks may need to stick to their tight monetary policies for an extended period. However, in emerging market economies, efforts to curb inflation seems to be bearing fruit, the advantages of early rate hikes are beginning to materialize.

Nonetheless, asset valuation among parties has been driven by the sole confidence of a ‘soft landing’ for the global economy, in which deflation proceeds at a rapid rate and a recession is averted.

Even if the severe strain on the world banking system has lessened, several nations still have a weak banking sector. Adverse feedback loops could be set off in the case of a rapid tightening of financial conditions, which would put the global financial system's resilience to the test once more.

In addition to risks associated with financial stress, other potential sources of macroeconomic risks may also have macro-financial ramifications. For example, a sharp increase in geopolitical tensions or a sharp uptick in China's economic activity may cause energy prices to spike sharply, driving headline inflation higher once more.

As a result, the need for transformation is acutely felt in the financial services industry. The global market uncertainty still lingers, regulators continue to exert pressure, environmental, social, and governance (ESG) issues are becoming more prevalent, and platforms, including embedded finance, and FinTech’s are disrupting the status quo.

The following key developments had a strong bearing on M&A and Capital markets’ activities across the global financial services market during the Q3’23:

- While both businesses and customers have so far managed to withstand rising interest rates and the pressure on cash flow, concerns grew louder during the quarter which might materialize swiftly if lending criteria become much stricter going forward
- Liquidity stress transmitted through parts of the international banking system and financial markets
- 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 deploy their 'eager capital'
- More stringent regulatory approval process ensured there were lesser big-ticket deals
- The focus seems to be shifting to long-term planning and M&A as a way of addressing strategic issues in the sector like market access, economies of scale, and technology debt as inflation and interest rates come under control, leading to a return of investor confidence and stability to banking markets

Sector Wise Performance (YTD'23)

Insurance stocks benefitted from strong retention, accelerated digitalization, interest rate hikes and reinsurance agreements

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

The **S&P 500** performed well driven primarily by the Technology sector which resulted in significant market rallies; partially offset the uncertainty brought on by failing regional banks

Banking stocks continue to remain severely impacted with negative investor sentiments on bankruptcy and emergency bailouts amidst systemic failures

FinTech stocks outperformed all the sectors despite the challenging market conditions as investors favored its attractive valuations post a strong sell-off last year

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

Shockwaves from weakening of Chinese economy, US interest rate hikes and a continuous negative global economic outlook continues to negatively impact the sentiments of the broader market

Key Sectoral Performance: Tale of 4 Key Sub-Sectors

Banking

- With inflation still high in many parts of the world, central banks are keeping interest rates higher for longer than currently priced in markets, slowing economic momentum
- Failure of major US banks in March, led to uncertainties in various areas of the global banking system, and this caused major volatility in some financial markets
- The additional regulation of increased capital requirements may have a greater impact on banks with less than US$100.0bn in assets, which could lead to smaller banks considering M&A

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
- M&A with direct pension fund involvement plunged in the Q3'23 to US$6.08bn down by 16.5% from US$7.28bn in the Q3'22
- The number of disclosed deals reduced during the period to 23, from 36 transactions in the previous year

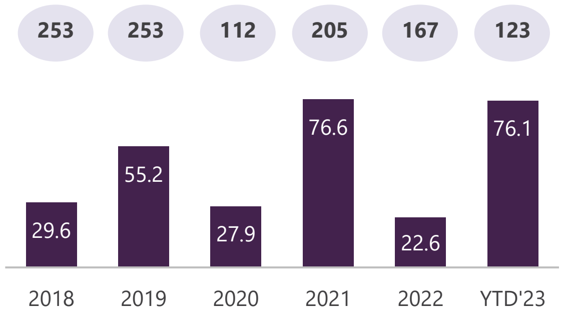


Figure: Count and Value of US Banks' M&A Deals (in US$bn)

- Looking ahead Q4'23 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

- Even though deal making has slowed down on account of higher cost of capital there are signs of positive buyer's interest which should stem the volume in the later part of the year
- As per OPTIS Partners, there were a total of 534 announced M&A deals of P&C insurance agencies in US & Canada compared to 720 deals in Q2'23
- The number of agency M&As fell by the highest amount ever seen through the first three quarters of 2023
- Divestments of complex legacy portfolios (high capital charges) as part of portfolio optimisation are on the rise

FinTech

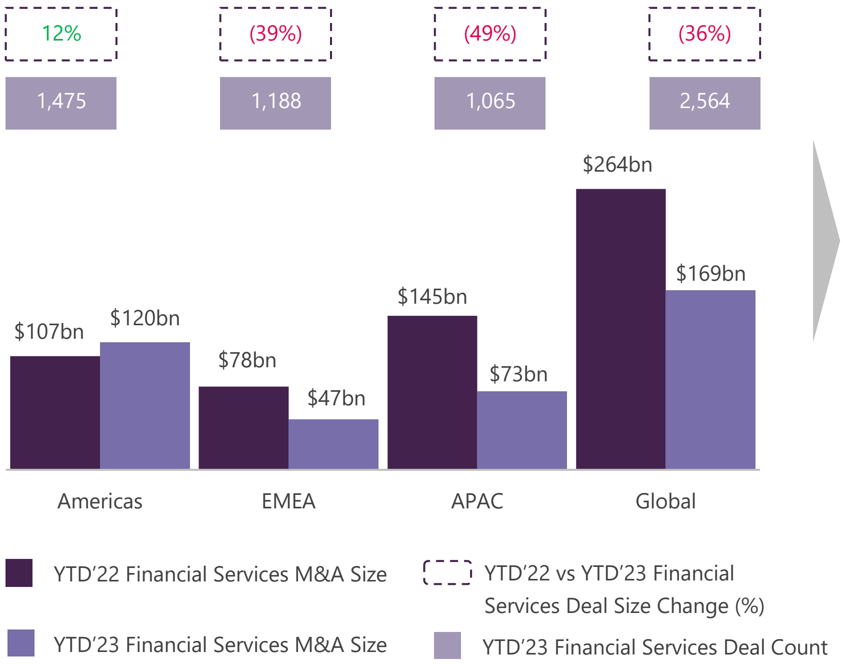
- FinTech M&A volume in Q3'23 was $33.0bn, an increase of 33% from Q2'23 ($25.0bn)
- InsurTech activity surged in Q3'23, with total volume increasing 131% over Q2'23 reaching $2.7bn, the highest level of all the FinTech sectors
- Global fintech funding dropped by 3% QoQ to hit $7.4bn in Q3'23, levelling off after seeing sharp declines in most quarters since the end of 2021
- It is expected that significant developments in blockchain, digital banking, mobile payments, cybersecurity, and API integration will start to emerge in 2024

Global Financial Services M&A YTD'23: Better Days Yet to Come

Global deal activity decreased in Q3'23 and YTD'23 as a result of rising inflation, interest rates, and geopolitical unrest. The drop in M&A activity in China and Southeast Asia, partially offset by an increase in deals in India, is the main reason why APAC volumes are still trending downward. As credit improves and deal makers appear to choose M&As as a countermeasure against these difficult times, there are pockets of development beginning to emerge especially in the US. While a miraculous cross-sectoral upturn in M&A activity is unlikely, there are some encouraging signs for possible deal-making, such as the recent rapid upturn in FinTech and InsurTech M&As.

While rising interest rates and tighter credit have made it difficult to complete leveraged deals, Private equity (PE) players have shifted their attention on conducting portfolio reviews, carrying out bolt-on acquisitions and making investments in cloud transformation, data and analytics capabilities.

Additionally, dealmakers anticipate an increase in M&A volumes from activist campaigns in the upcoming quarters due to depressed market valuations, which also provided a chance for notable activist investors to start new proxy battles. While the M&A market is anticipated to remain difficult in Q4'23, we anticipate that there are plenty of opportunities to carry out strategic deal across the FS sector, albeit with greater discipline and caution.



Source: Refinitiv. Figures in US$bn. Data as of Nov 02, 2023.

The market saw a fall in the number of big-ticket deals, (deals where the transaction value is greater than or equal to US$1.0bn). In Q3'23, there were 98 big ticket deals, a 15% decline compared to Q3'22.

Shengjing Bank's portfolio acquisition by Liaoning Asset Management for US$24.0bn, Worldpay's acquisition by GTCR, for US$18.5bn and UniCredit and Alpha Bank's merger, for US$6.9bn are some of notable big-ticket

Some of the key observation during YTD'23:

- Corporates with strong balance sheets and sound M&A processes still have a competitive advantage in the current market as they have the cash and the ability to extract synergies
- To finance significant deals, PE players are combining financing mechanisms such term loans, seller notes, all-equity funding, earn-outs, consortium deals (including with sovereign wealth funds, pension funds, and family offices), and minority investments
- 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

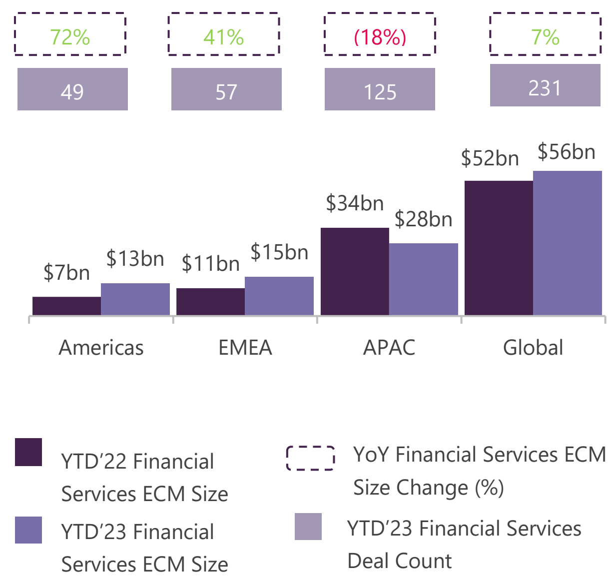
Key M&A Themes

Strategic partnerships	Business expansion	Emergency bailout	Restoring stability
Increasing market share	Boosting shareholder's return	Accelerated digitization	Enhancing capabilities

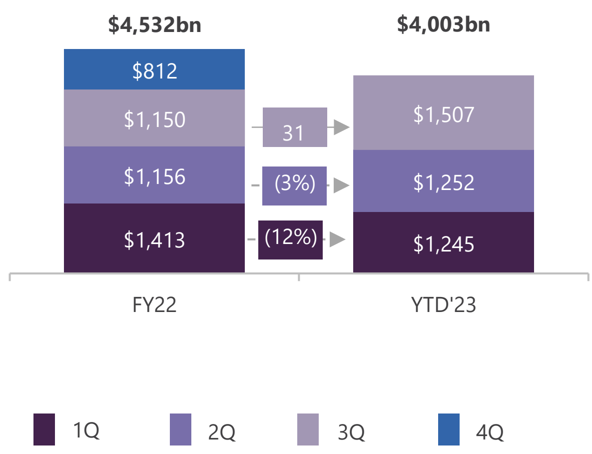
Financial Services Funding: Focus on Quality as Markets Starts to Rebound

The Debt Capital Market (DCM) has shown pockets of optimism this year with issuers having largely been able to push out near-term maturities this year amid tight credit conditions. The increase in issuance in 2023 may have been influenced by a resurgence in M&A activity; at the same time, several large corporations have been compelled to return to the debt market to refinance debt as previous debt matured (Investment grade securities). Demand in the syndicated loans market remained muted due to concerns over profitability, high costs of debt and a reversion to more conservative underwriting standards. The resurgence in Equity Capital Market (ECM) activity was driven by the perception of stability in interest rates, strong base effect (soft y-o-y figures) and the economy and listing companies' willingness to accept valuation resets. Majority of the deal activity was restricted to secondary financing of public Biotech companies. The IPO backlog continues to grow and with some early indications of macroeconomic stability, a stronger pick up can be anticipated in the last quarter of the year and 2024.

Global Financial Services ECM



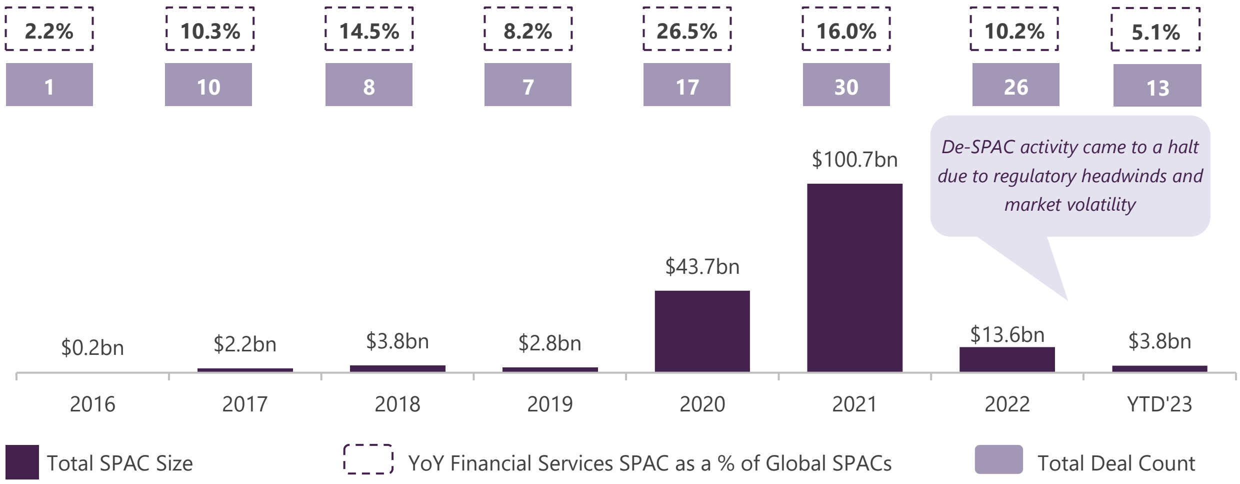
Global Financial Services DCM & Syndicate Loans



Source: Refinitiv data as of Nov 03, 2023. Figures in US$bn; ECM=Equity Capital Market, DCM=Debt Capital Market

SPACs: Imminent Liquidations as the Merger Clock Expires

We continue to believe that the success or should we say the existence of the SPACS going froward will be heavily dependent upon their ability to adapt to the changing financial legislation and competitive environment. The heightened regulatory scrutiny along with excessive redemptions during De-SPAC, a virtually non-existent PIPE market, overcrowding and “SPAC-off” processes have diminished the traditional appeal to investors. Though funding has dried up in the last one-year, innovative deal structures and better due diligence can still revive investors’ faith and stability. In terms of deal volumes, SPAC merger announcements have decreased in comparison to the previous quarters. Overseas targets are more in focus than ever and sponsor economics are more negotiable with the rising number of redemption mitigation mechanisms. However, prevalence of high interest rates and expectation of further uptick in the future may further prolong the dry spell for SPAC IPOs even as traditional route shows signs of recovery. As a result, deal volumes should ideally mirror pre-pandemic levels with focus on FinTech.



Source: Eikon Refinitiv. Figures in US$bn. Data as of ending September 30, 2023.

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.

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.

Currently, 15 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 US antitrust scrutiny as well.

Q4’23 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 fourth quarter of 2023:

1. **Enhanced underwriting capabilities for banks:** Given the sharp decline in market conditions from the time the deals were announced until they concluded, banks have effectively sold off the majority of the debt from the 2022 LBOs that they kept onto. As a result, they will be better equipped to underwrite new projects in the following quarters.
2. **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.
3. **Capital-constrained environment:** Stronger emphasis is expected on divestitures as companies attempt to deleverage their balance sheets, free up funds for reinvestment, or, in the case of private equity, return capital to their investors.
4. **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 H2’23, it's anticipated that M&A and strategic alliances will be focused on transactions which will leverage data, address growing cybersecurity concerns, drive operational efficiencies, and speed up transaction processes.
5. **Private Equity Support:** While fundraising activity has slowed, dry powder remains near all-time highs, providing opportunity for companies with minimum viable products and established business plans. It is projected that competition for key technologies, ESG objectives, supply chain resilience, and recession-proof industry deals will drive deal making through H2’23 as businesses navigate the current market volatility and become ready for long-term development.
6. **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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