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Global Financial Services Industry: M&A and Capital Market Landscape 2023 Review

Contents

Global Financial Services Market 2023: Light at the End of the Tunnel 3
Key Sectoral Performance: Tale of 4 Key Sub-Sectors 4
Global Financial Services M&A 2023: Tough but Cautiously Optimistic 5
Financial Services Funding: Selective Optimism as Markets Start to Rebound 7
SPACs: Innovative Deal Structures are the Need of the Hour 8
ESG: Key to Long-term and Sustainable Value Generation 8
2024 Outlook: Spotlight on Adaptability and Rebuild 9
Authors 10
Evalueserve Disclaimer 11

Global Financial Services Market 2023: Light at the End of the Tunnel

The year 2023 was a crucial one for the global financial markets. The post COVID recovery led to one of the fastest and most aggressive interest rate tightening cycles in history, which impacted deal making across the broader market.

Nonetheless, the much-feared US recession did not occur in Q4’23 as labour markets held steady and inflation decreased. Instead of the much-feared slowdown in growth, an elusive "soft landing" for the economy may be on the horizon, with inflation returning to the Fed's target range and a strong labour market maintaining high levels of discretionary income for workers. These elements played their part in driving the strong stock performance that persisted throughout the year.

Federal Reserve's signal that the two years of rising interest rates would probably come to an end, strong economic growth data, an easing of inflation as many supply chain issues healed, and a surge in excitement about the potential applications of artificial intelligence (AI) in the future were the other key positive developments during the year.

These positive developments helped to somewhat counteract the global decline in M&A activity, which was at its lowest point in a decade. Boardroom appetite for M&As was impacted by high cost of capital and economic uncertainties in H1'23. Recent investor feedback suggests that we may have weathered the worst of it, though. Decelerating inflation and anticipated interest rate decreases are projected to support financial markets. However, because of ongoing geopolitical and economical challenges, it is still unclear precisely when and how robust the rebound will be.

The following key developments had a strong bearing on M&A and Capital markets’ activities across the global financial services market during 2023:

- Liquidity stress transmitted through parts of the international banking system and financial markets
- Uncertainty created by macroeconomic factors such as high inflation, rising interest rates and lower economic growth projections during the year dampened M&A activity
- While macroeconomic conditions and geopolitical tensions remain challenging, recent gains in the financial markets and positive signals about interest rates from central banks revived investor confidence
- Despite decreased M&A activity, financial sponsors continue to maneuver through more expensive and constrained financing markets by employing seller rollovers, bigger equity contributions, and other kinds of funding
- Spotlight on divestitures of non-core assets as businesses attempted to strengthen their balance sheets and make their business models more resilient
- 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 (2023)

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

The **asset management** stocks recovered majorly due to positive performance shown by risk assets, particularly long-term bonds, high yield and cyclical stocks,

The **S&P 500** performance was robust primarily by the Technology sector & optimism over AI which resulted in significant market rallies; partially offset the uncertainty brought on by failing regional banks

Banking stocks rose due to decline in short-term investment rates which will lead to increase in demand for goods, helping banks in making more loans

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

The market rebound in 2023 was primarily driven by investors' increasing optimism that the Fed would soon begin decreasing interest rates thereby signaling greater liquidity and lower cost

Key Sectoral Performance: Tale of 4 Key Sub-Sectors

Banking

- 2023 saw a decrease in M&A activity compared to 2022 due to concerns about bank failures, changes in interest rates, and possible risks in loan books
- However, US bank mergers of equals reached a three-year high in 2023, serving as an attractive option for banks to pair up and gain scale amid a lack of buyers
- 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

- Companies are focusing more into strategic alliances to optimize cost structures in addition to growing revenue
- 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 Q4’23 to $2.66bn down by 78.9% from $12.63 in the Q4’22
- The number of disclosed deals reduced during the period to 25, from 41 transactions in the previous year
- Looking ahead Q1’24 is expected to witness a continuation of M&A activity due to pressure

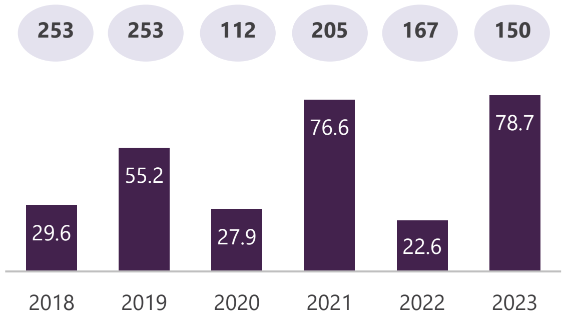


Figure: Count and Value of US Banks' M&A Deals (in US$bn)

on returns, market conditions having an influence on margins and profitability, and scale and consolidation being considered as essential solutions

Insurance

- Insurance corporations continue to divest capital-intensive life and annuity businesses to focus on core products and reduce complexity in their operations
- As per OPTIS Partners, there were a total of 782 announced insurance-agency M&A in 2023, down 24% from 1,031 in 2022
- Insurance companies are collaborating with Insurtechs to take advantage in areas such as machine learning and artificial intelligence capabilities

FinTech

- FinTech M&A volume in 2023 was US$29.9bn, down from US$37.6bn in 2022
- Despite challenges, early-stage fintech investments were still strong globally, with seed rounds securing over US$4.0bn in 2023
- Firms remain interested in exploring options and are looking forward to potential deals when market conditions improve
- It is expected that significant developments in blockchain, digital banking, mobile payments, cybersecurity, and API integration will start to emerge in 2024

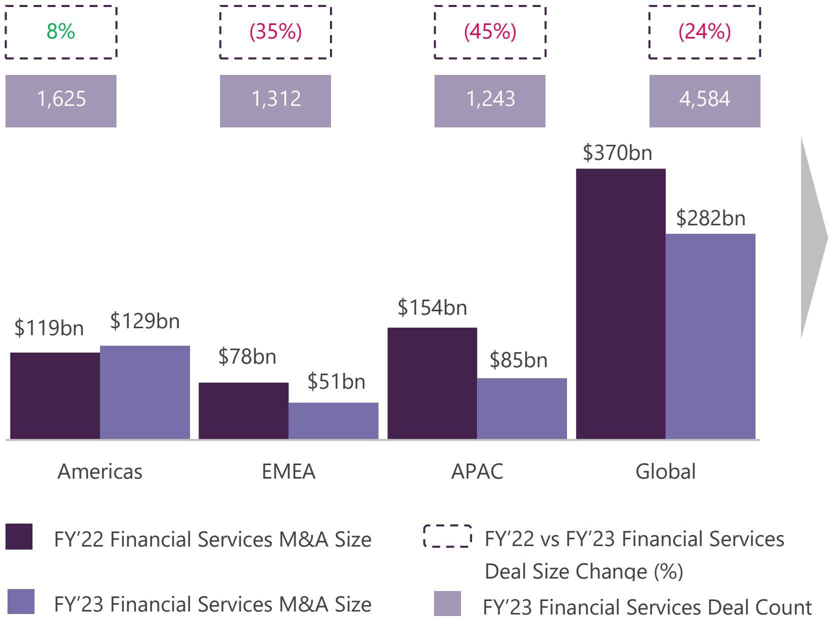
Global Financial Services M&A 2023: Tough but Cautiously Optimistic

Higher interest rates and tighter financing markets made deal making more challenging for financial sponsors in 2023. M&A activity in APAC continued to show a downward trend majorly due to decline in M&A activity in China and Southeast Asia, partially offset by a surge in deals in India.

However, the US markets witnessed positive trends in M&A especially because of the banking sector which supports as regional lenders for M&A especially tough times. 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. While a miraculous cross-sectoral upturn in M&A activity might be challenging, 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 improve in the coming quarters Insurance brokerage, asset management and Fintech market remains the hotspot for M&A in 2024.



Source: Refinitiv. Figures in US$bn. Data as of Dec 14, 2023.

Dealmakers are favoring smaller transactions, rather than megadeals, to curb M&A related risks.

NFP's acquisition by AON for $13.4bn, Global Atlantic's acquisition by KKR, for $2.7bn and National Western Life Group, and Prosperity Life Group's merger, for $1.9bn are some of notable big-ticket deals(where the transaction value is greater than or equal to US$1.0bn) during the quarter.

Some of the key observation during 2023:

- Steady flow of carve-outs, spin-offs and joint ventures that offered creative ways to achieve strategic goals
- Due to strict merger scrutiny by the regulators the buyers had to wait longer for deal negotiations which ultimately led to a decline in volume
- 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
- Activism remained a significant factor, with many campaigns pressing for M&A transactions to enhance shareholder value
- 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

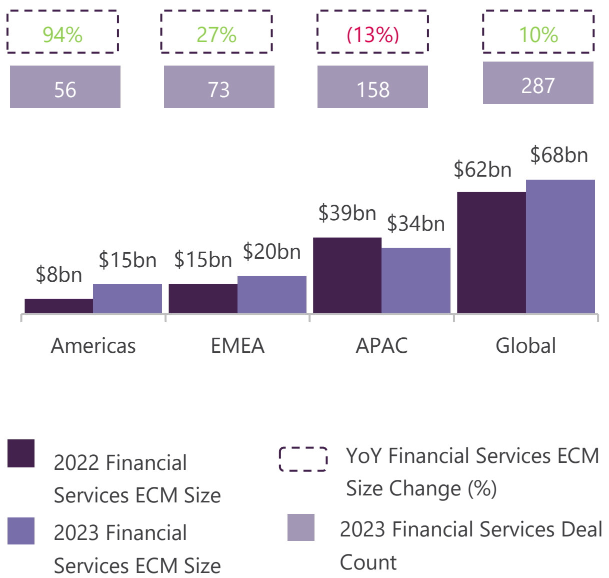
Key M&A Themes

Strategic alliances	Business diversification	Business expansion	Restoring stability
Increasing market share	Operational synergies	Accelerated digitization	Enhancing capabilities

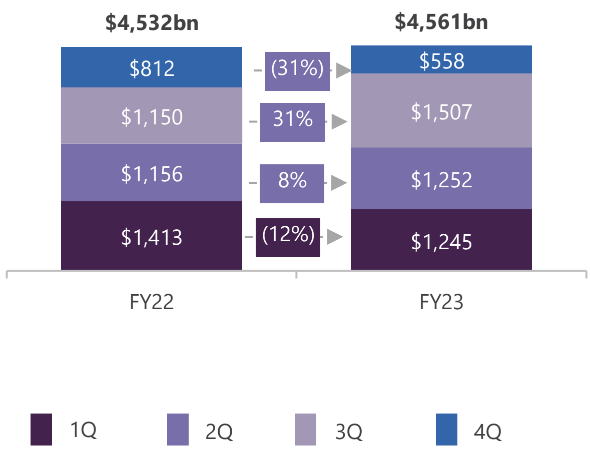
Financial Services Funding: Selective Optimism as Markets Start to Rebound

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 (Q2 and Q3) 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. Overall, looking ahead we expect refinancing deals to remain under focus in 2024 with anticipation of modest interest rate increases, likely to give an improved market tone for deals. 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 2024 especially for mid-size offerings.

Global Financial Services ECM



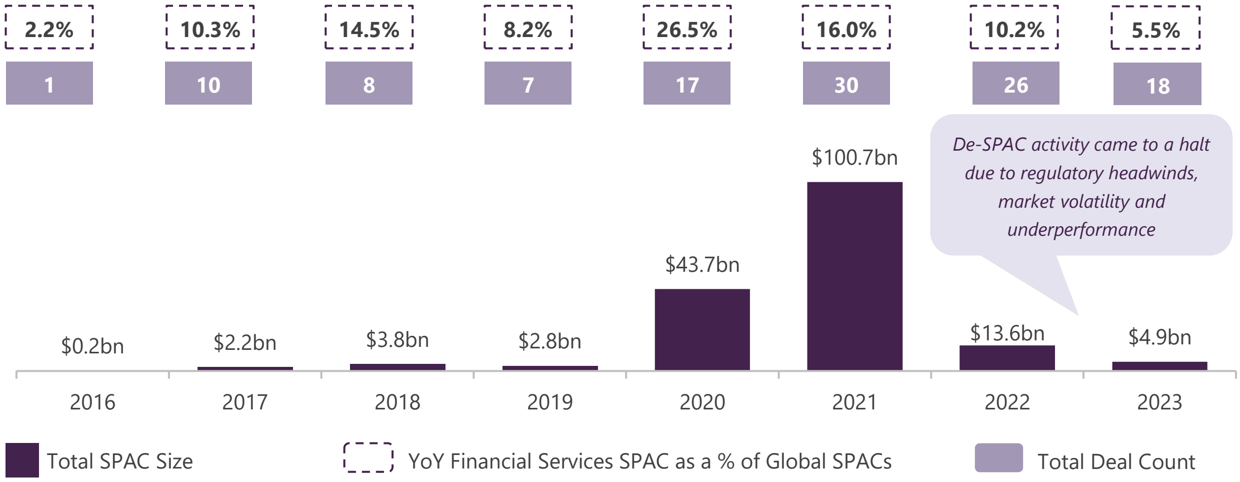
Global Financial Services DCM & Syndicate Loans



Source: Refinitiv data as of Dec 14, 2023. Figures in US$bn; ECM=Equity Capital Market, DCM=Debt Capital Market

SPACs: Innovative Deal Structures are the Need of the Hour

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 December 31, 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.

2024 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 in 2024:

1. **Financing structures:** Even if interest rates stabilize and finally begin declining in 2024, as the market seems to anticipate, we expect to see the creative use of financing structures continue to play a role in financial sponsor deals i.e. carve-out/spin-off.
2. **Digital payments:** Despite the ongoing macroeconomic difficulties and their implications on the M&A market, the payments sector continues to be quite appealing for the investors. The payments business is seen as more profitable, scalable, and less regulated than other areas of the financial services industry by corporates in the banking and payments sectors as well as private equity firms.
3. **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.
4. **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.
5. **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 H1'24, 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.
6. **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 H1'24 as businesses navigate the current market volatility and become ready for long-term development.

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