EVALUESERVE

Global Financial Services Industry: M&A and Capital Market Landscape Q1'24 Review

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Global Financial Services Market Q1’24: A fantastic start of the year

The first three months of 2024 witnessed stronger than anticipated growth driven by robust consumer spending, above-average economic growth, a strong job market, rising profit expectations, and the possibility of rate cuts later this year.

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

The financial markets' recent upswing offers the conditions for a more robust M&A market to resume. Most bankers anticipate three to six rate cuts in the US, signaling the end of the interest rate hikes that have been occurring frequently over the last two years. The funding environment will be more stable even if rates decline more gradually, making it simpler for dealmakers to price, carry out, and arrange their agreements.

We anticipate that strategic purchasers will carry on with their practice of making bolt-on, lower-value purchases in 2024 to enhance their current product and geographic portfolios. In the fintech industry it is expected that the strategic buyers' venture arms will continue to take minority investments in fintech companies.

The following key developments had a strong bearing on M&A and Capital markets’ activities across the global financial services market during Q1’24:

- Confidence for deal making has improved on the back of strong earnings, potential interest rate cuts this year and an ebullient market
- While several investment grade companies borrowed to seek high-value targets throughout the quarter, numerous bigger companies took advantage of attractive valuations to finance huge deals.
- Structured deals, which include spin-offs, separation, and carve-out transactions, also drove volumes
- 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
- Spotlight on divestitures of non-core assets as businesses attempted to strengthen their balance sheets and make their business models more resilient
- 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'24)

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 spike in **S&P 500** performance was the biggest first quarter gain since 2019 primarily driven by the Technology sector & optimism over AI which resulted in significant market rallies

Banking stocks showed positive gains because of central bank's view to keep three interest rate cuts this year while upgrading its economic outlook

FinTech stocks outperformed all the sectors and continue to show positive trends 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

In Q1'24 the recovery was broad-based and was majorly driven by the confidence of a "soft landing" for the global economy with moderate inflation with minimal probability of a recession

Key Sectoral Performance: Tale of 4 Key Sub-Sectors

Banking

- The M&A deal volume in Q1'24 increased as compared to Q1'23.
- In fact, the largest deal of the first quarter (Discover Financials' acquisition by Capital One for $35.3bn) came from the banking sector, representing the largest US bank deal in over 15 years
- US bank M&A activity is anticipated to increase in 2024 as a result of the recent decrease in medium-term interest rates, with multiple US banks already expressing interest in pursuing M&A agreements.
- However, recent decision by The Office of the Comptroller of the Currency's to improve

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
- In the first three months of 2024, mergers and acquisitions with direct pension fund involvement fell for the second consecutive quarter.
- Transaction value totalled $1.26bn, a 91.7% decline from $15.27bn in the first quarter of 2023. The number of deals went down to 27 from 31 YoY

transparency of bank M&A review process may hinder deal making in future

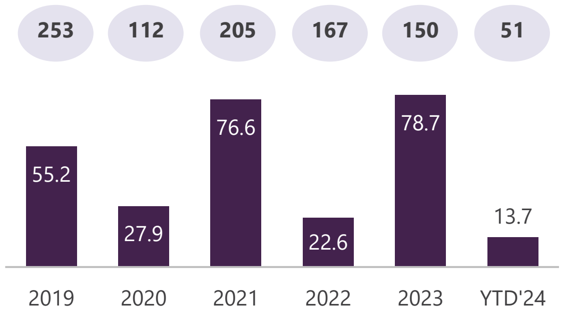


Figure: Count and Value of US Banks' M&A Deals (in US$bn)

- Looking ahead 2024 is expected to witness a slow 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

- 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 155 announced insurance agency mergers and acquisitions in the first three months, down 18% from 188 during the first quarter 2023
- Insurance companies are collaborating with Insurtechs to take advantage in areas such as machine learning and artificial intelligence capabilities

FinTech

- Despite growth in broader venture funding, fintech funding continued to slide in Q1'24, declining 16% QoQ to $7.3bn
- Fintech deal volume, on the other hand, increased for the first time since Q1'23
- 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 soon.

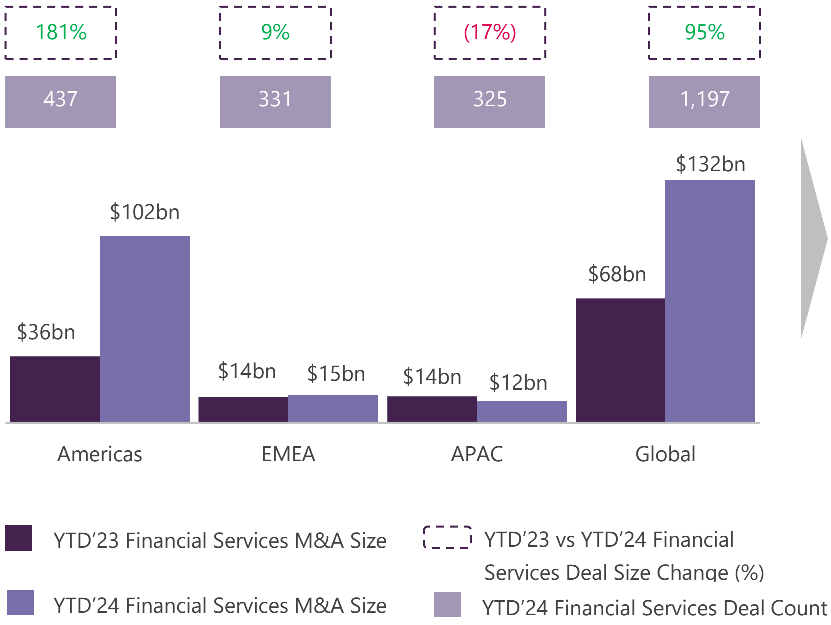
Global Financial Services M&A Q1'24: Outlook remains strong

Recent improvements in liquidity and economic conditions herald a potential rebound in M&A activity this year. World-wide M&A activity increased 38%, year-on-year in Q1, driven largely by large domestic US acquisitions. During the quarter, several large companies capitalized on strong valuations to finance big deals, while some investment grade companies borrowed to pursue high-value targets. With US target companies accounting for more than 50% of world-wide deals in the first three months of 2024. There has been promising recovery in Europe M&A activity as well. M&A activity in APAC continue 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.

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.



Mergers and acquisitions rebounded in the first quarter after a downbeat 2023, thanks to the return of mega deals

Discover Financials' acquisition by Capital One for $35.2bn and Truist Insurance's acquisition by Trident Butterfly for $12.6bn are some of notable big-ticket deals (where the transaction value is greater than or equal to US$1.0bn) during the quarter.

Source: Refinitiv. Figures in US$bn. Data as of April 18, 2024.

Some of the key observation during Q1'24:

- Steady flow of carve-outs, spin-offs and joint ventures 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

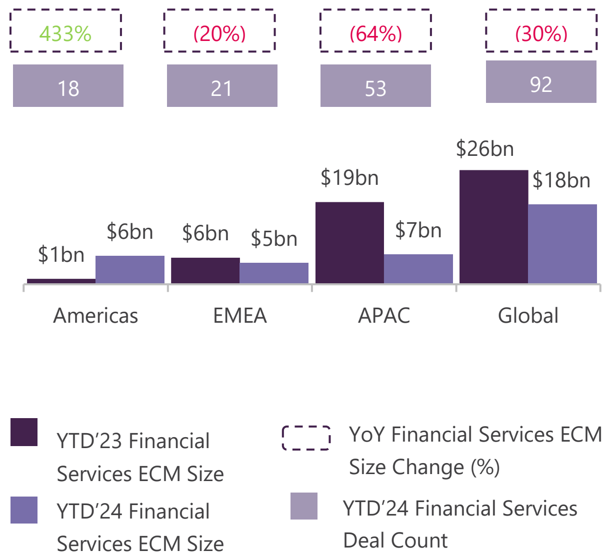
Key M&A Themes

Strategic alliances	Business diversification	Business expansion	Strengthen balance sheet
Boosting market share	Operational synergies	Accelerated digitization	Enhancing capabilities

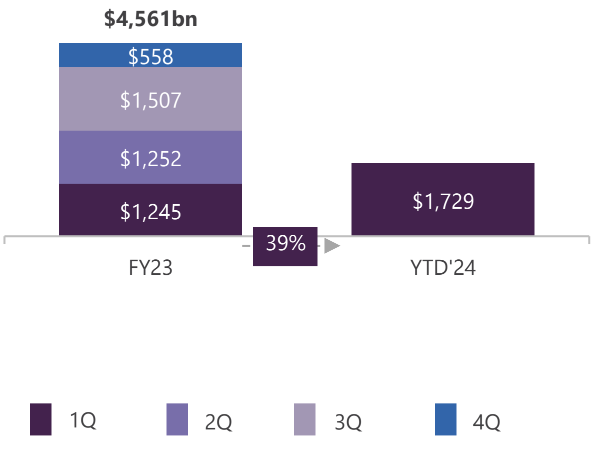
Financial Services Funding: Selective Optimism as Markets Start to Rebound

The Debt Capital Market (DCM) showed pockets of optimism in Q1'24 with issuers largely been able to push out near-term maturities amid tight credit conditions. Majority of the deals were related to refinancing and repricing which were driven by the lack of new supply. Investors also exhibited greater risk tolerance as banks have been more active, resulting in increased M&A financing in the syndicated debt markets and more favorable pricing as the first quarter continued. Aided by strong investor interest and tighter spreads, borrowers refinanced more costly private credit with more affordable widely syndicated loans. There was some resurgence in Equity Capital Market (ECM) activity after 2 years, driven by the perception of stability in interest rates and inflation, strong base effect (soft y-o-y figures) and better economic growth prospects and listing companies' willingness to accept valuation resets. Majority of the deal activity was restricted to FinTech. The IPO backlog continues to be robust with companies planning to get themselves listed before changes in the political landscape later in the year (such as the US election). This should ideally drive volume in the coming quarters this year.

Global Financial Services ECM



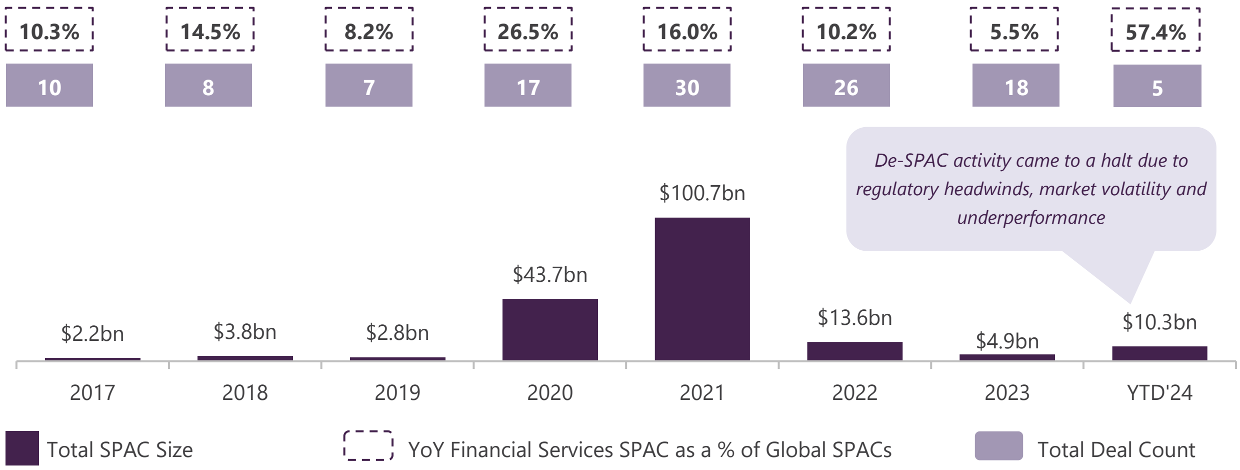
Global Financial Services DCM & Syndicate Loans



Source: Refinitiv data as of Apr 18, 2024. 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. The volume of these transactions will probably continue to be impacted by the SEC's recent implementation of new rules designed to improve investor safety by mandating more disclosure and harmonizing reporting requirements with regular IPOs. 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 April 30, 2024.

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 2024:

1. **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.
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. **Emerging markets will become centers for FinTech**: Global governments will make more investments in South East Asia, the Middle East, and Africa to expand their fintech ecosystems and bolster the regions' digital economies.
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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