EVALUESERVE

Global Financial Services Industry: M&A and Capital Market Landscape Q3'24 Review

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Global Financial Services Market Q3'24: Rate Cut to Recovery

In September 2024, the Federal Reserve took a crucial step by lowering interest rates by 0.5%. This was the first rate drop since the early stages of the COVID-19 epidemic. The previous "higher for longer" interest rates had caused property values to decline, which in turn has severely impacted the banks and borrowers. The current rate cycle should see lower lending rates, which will lead to greater leverage ratios and M&A valuations, particularly for LBOs. As in the past, lower rates and higher multiples are expected to encourage more M&A activity, particularly as the current environment appears to be more favorable than in the previous two rate cut periods.

Geopolitical risks continue to be high, as there remains policy uncertainty due to upcoming global elections. All these factors continue to cause volatility in the financial market and thereby creates an environment of uncertainty regarding the future of the global economy.

Furthermore, the financial services (FS) sector is subject to other industry-specific issues, such as pressure on costs and asset quality, as well as uncertainty surrounding global central banks' interest rate policies. These factors collectively put a burden on the profitability and equity of FS businesses. In such complex scenario M&A should continue to be an integral part of the transformation process across the sub-sectors with focus on enhancing capabilities and driving future growth in the given current socioeconomic climate were organic growth face various headwinds.

Dealmakers are overall mostly optimistic about the medium-term M&A picture which is expected to remain profitable and relevant due to pressures induced by digitalization, questions on sustainability and current workforce challenges.

We anticipate that strategic purchasers will carry on with their practice of making bolt-on, lower-value purchases in Q4'24 to enhance their current product and geographic portfolios. In the FinTech industry we expect 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 Q3'24:

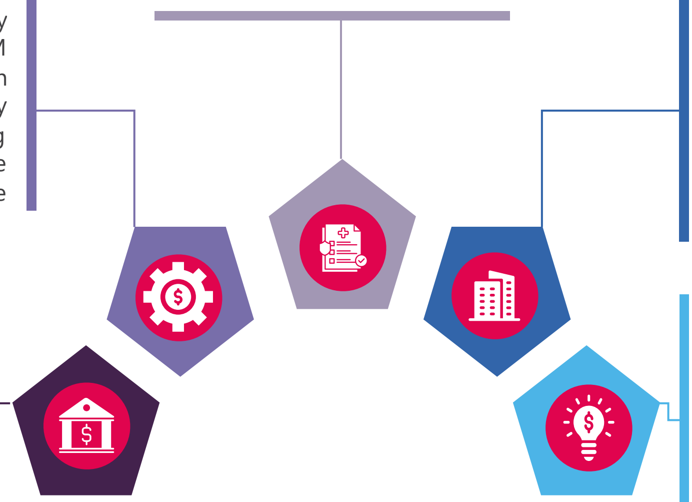
- Companies are exploring foreign investments to bring in cutting-edge technology, global best practices, increased product offerings and improved access to capital for the next level of growth
- While several investment grade companies borrowed to seek high-value targets throughout the quarters, numerous 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 reduction of 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 outperformed mostly because of robust investor sentiment and significant market interest in the sector

The **asset management** stocks recovered majorly due to improved AUM levels that lead to growth in revenue and profitability of the companies resulting in better share price performance

The spike in **S&P 500** performance was primarily driven interest rate cut by Fed after a sell-off in late July / early August as investors reacted to a weaker-than-expected jobs data



Banking stocks showed positive gains with monetary easing cycle. The Fed is expected to continue reducing rates through 2025

FinTech stocks performed well and continued to show positive trends as investors favored its attractive valuations and strong earning visibility

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

Despite ongoing challenges, the Fed's rate cut, strong corporate earnings, and resilient consumer spending helped the market reach new highs in Q3'24

Key Sectoral Performance: Tale of 4 Key Sub-Sectors

Banking

- The M&A deal volume improved in 2024 compared to 2023 but remain slow due to uncertainties connected with interest rate developments, evolving capital regulations, more regulatory scrutiny of mergers, and potentially increasing risks in loan books, particularly around commercial real estate
- Considering the deals by region 17 banks in the Midwest have been targeted in 2024, making it the most-targeted region, followed by the West with 13 target banks in the US
- US bank M&A activity is anticipated to increase in Q4'24 because of the recent decrease in medium-term interest rates, with multiple US banks already expressing interest in pursuing M&A agreements.

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
- Mergers and acquisitions with direct pension fund involvement soared high in the second quarter of 2024.
- The Wealth Management M&A market remains strong, with 51 transactions completed in Q3 2024 and 159 for YTD Q3 2024
- Private equity-backed acquirers continue to play a pivotal role in the market, accounting for 77% of acquisition in YTD 2024.
- Asset management business volumes are expected to continue to rise because of the

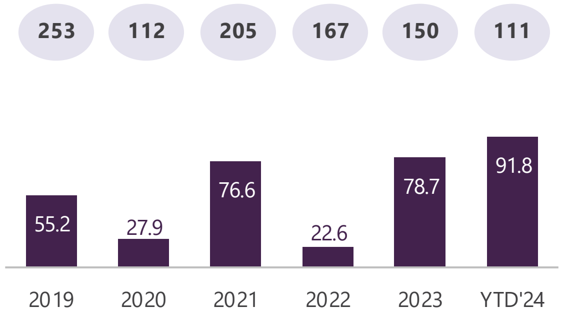


Figure: Count and Value of US Banks' M&A Deals (in US$bn)

potential for a minor reversal of macroeconomic conditions and future interest rate reductions.

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 535 announced insurance agency mergers and acquisitions in the Q1-Q3 2024, down 10% from 594 during the Q1-Q3 2023
- Insurance companies are collaborating with Insurtechs to take advantage in areas such as machine learning and artificial intelligence capabilities

FinTech

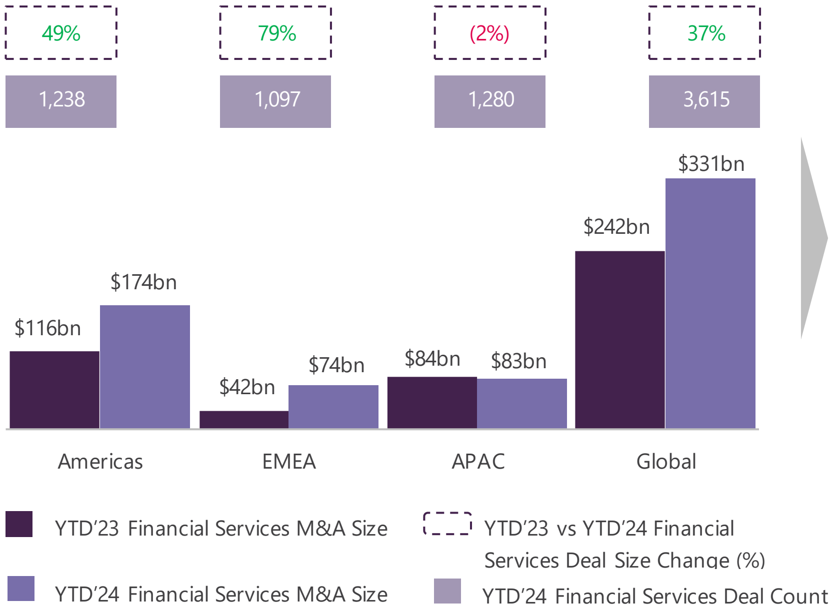
- Despite growth in broader venture funding, fintech funding declined by 57%% in Q3'24, compared to Q3'23
- The total capital invested in fintech globally were amounted to $16.4bn, compared to $36.7bn in H2'23
- Although private equity is making fewer bets, they are increasing in size as late-stage fundraising rounds become the primary focus of investment
- Significant developments in blockchain, digital banking, mobile payments, cybersecurity, and API integration will start to emerge soon.

Global Financial Services M&A YTD'24: Market Rebounds!

Recent improvements in liquidity and economic conditions herald a potential rebound in M&A activity this year. Global M&A activity increased by 37% in YTD'24 (soft comparable), driven largely by the US and European big-ticket 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. US-based companies accounted for a larger part of world-wide deals in Q3'24. As the economies in Europe continue to grow and market confidence improved further due to anticipated additional interest rate reductions, M&A deal activity rebounded significantly in Q3'24 vs y-o-y. Deal activity in APAC improved however declined in terms of y-o-y figures due softer numbers 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.

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.



Mergers and acquisitions rebounded in the 2024 after a downbeat in 2023, thanks to the return of mega deals

Acquisition of Private Student Loan portfolio of Discover Financial by KKR for S$10.8bn and McGriff Insurance Services by Marsh & McLennan Agency for US$7.8bn were 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 October 17, 2024.

Some of the key observation during Q3'24:

- 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

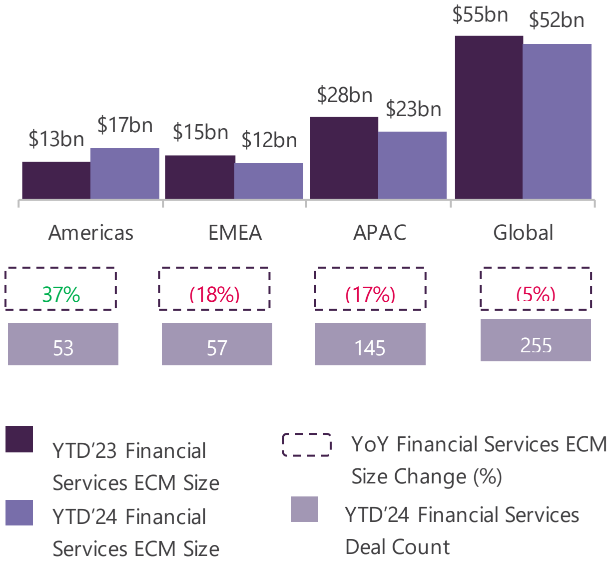
Strategic alliances	**Banking consolidation**	**Business expansion**	**Strengthen balance sheet**
Boosting market share	**Operational synergies**	**Accelerated digitization**	**Enhancing capabilities**

Funding: Volumes Rebounds as Optimism Grips the Market

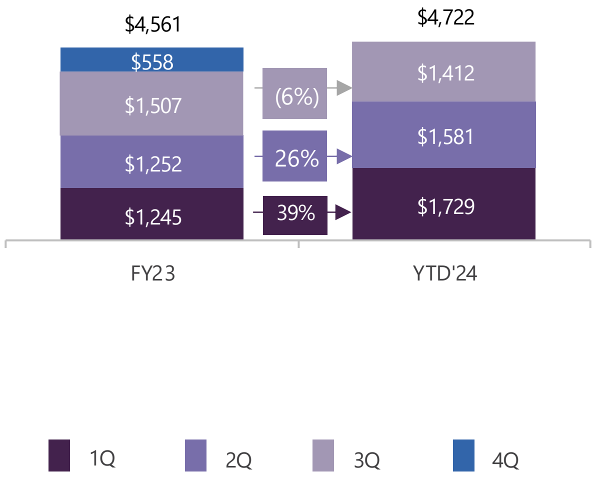
The Debt Capital Market (DCM) showed high optimism in 2024 with issuers largely been able to push out near-term maturities amid tight credit conditions. The majority of the deals were related to refinancing and repricing which were driven by the lack of new supply. Investors also exhibited greater risk tolerance as banks have been more active, resulting in increased M&A financing in the syndicated debt markets and more favorable pricing during the quarter. Aided by strong investor interest and tighter spreads, borrowers refinanced more costly private credit with more affordable widely syndicated loans. Overall, looking ahead we expect refinancing deals to remain under focus in Q4'24 with interest rate cuts and Central Bank stimulus globally, likely to give an improved market tone for deals offset a bit by some political headwinds.

The resurgence in Equity Capital Market (ECM) is primarily driven by the perception of lower in interest rates and easing 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 came from FinTech companies with investors focusing on innovation and growth. 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 continue to drive volumes in the Q4'24.

Global Financial Services ECM



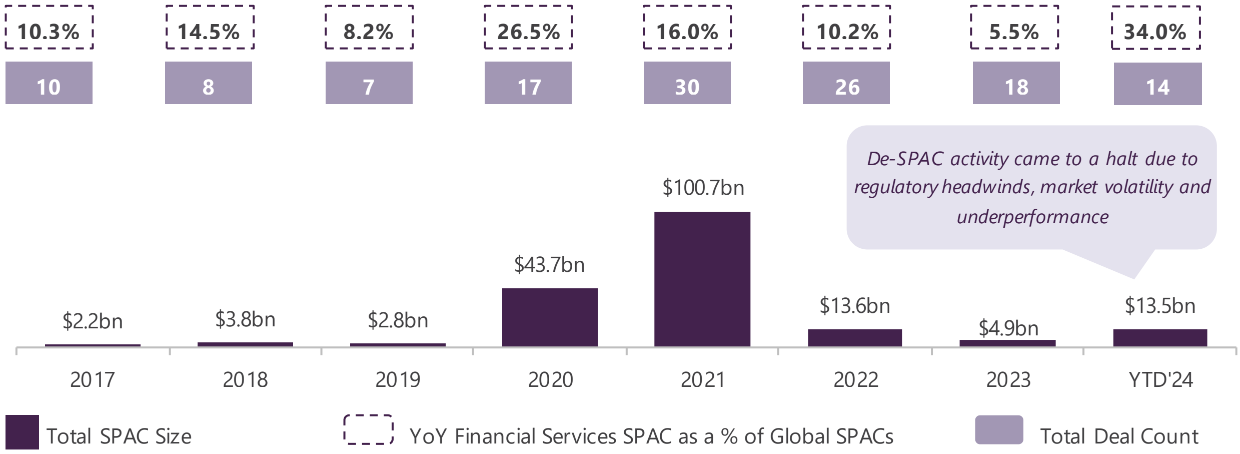
Global Financial Services DCM & Syndicate Loans



Source: Refinitiv data as of October 17, 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 forward 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 Oct 17, 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.

Q4'24 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 Q4'24:

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. **ESG:** ESG factors are becoming increasingly important to investors when making judgments about investments and formulating company plans. They have refocused their attention from asset managers and insurers on the ESG risks in their private investment portfolios due to recent geopolitical tensions
3. **Emerging markets are expected to 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. **Restructuring:** Participants in the FS market are observing increasing indications of a decline in credit quality. They anticipate restructuring, such as the sale of non-core assets or non-performing loans (NPLs), to bolster balance sheets and raise capital ratios in the banking industry.
5. **Digital transformation:** Digitalization and artificial intelligence (AI) continue to be strategic goals for financial services players to address consumer expectations and establish market position. Transaction activity in H2'24 is expected to focus on deals to leverage data, implement solutions to growing cybersecurity concerns, drive operational efficiencies, and expedite transaction process
6. **Private Equity:** Insurance brokerage, platforms, fintech, insurtech and regtech are expected to be in the crosshair of deal makers. We therefore anticipate more M&A activity in these sectors as increased cost of capital and restrictions on leverage putting pressure on returns for PE investors, value creation will be more crucial than ever.

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Arjun has 9+ years of experience in working with offshore investment banking teams.

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