Global M&A themes 2018

Banking & Capital Markets

EY

Building a better working world

Contents

Methodology

- This publication is based on analysis of ThomsonONE.com and Mergermarket M&A data.
- We included selected additional transactions that were not in the databases.
- Deals include transactions (announced or completed) in which the target is in the banking sector.
- Deals in which less than 20% (disclosed) of the company was acquired have been excluded from this analysis.
- Equity investments were included.
- JVs were not included.
- There is no minimum disclosed value deal threshold.
- The information and opinions contained in this document are derived from public and private sources that EY believes to be reliable and accurate but which, without further investigation, cannot be warranted as to their accuracy, completeness or correctness. This information is supplied on the condition that EY, its member firms, or any leader or professional of any thereof are not liable for any error or inaccuracy contained herein, whether negligently caused or otherwise, or for loss or damage suffered by any person due to such error, omission or inaccuracy as a result of such supply.

Foreword

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Welcome to the 2018 edition of our Global M&A themes: *Banking & Capital Markets*. This report reviews 2017 M&A activity across the banking sector, examines forward-looking confidence levels and related drivers from our latest *Global Capital Confidence Barometer,* and dives into the three main global markets (Americas, Europe and Asia-Pacific) to provide our outlook on the drivers of M&A in 2018.

Global banking sector M&A volumes and values fell by 16% and 34% respectively in 2017, reflecting a continued move away from megadeals. However, signs of strength were evident in mid-market M&A, as well as the payments and FinTech segments. Globally, the banking sector appears to have regained its confidence and, with improving macroeconomic indicators, is now pivoting back to a growth agenda, which will drive M&A activity. We also expect that private equity (PE) will increasingly invest globally in areas, such as banking infrastructure, consumer lending, payments and nonperforming loans (NPLs).

According to our *Global Capital Confidence Barometer*, dealmakers around the world are confident about the state of the global economy, with 41% intending to pursue acquisitions. We believe that a large share of transactions will be aimed at either futureproofing business models against the threat of digital disruption or gaining access to better technology and distribution capabilities. In a capital-constrained world, we expect JVs and alliances to be the preferred deal structures, while banks will also use their VC arms to gain early access to smaller high-growth businesses.

At the start of 2018, with the emergence of regulatory clarity and the completion of many banks' noncore disposal programs, banks can shift their focus from fixing the bank of the past to building the bank of the future. As a result, in 2018, we will see an increased focus on growth targets that will help banks achieve digital maturity and scale up their core businesses.

Global banking deal activity

697 deals in 2017

US$108b deal value

16% decrease in the number of deals compared with 2016

34% decrease in the value of deals compared with 2016

2017 was a slower year for the global banking M&A market, with both deal activity and total disclosed deal value at their lowest levels since our analysis began in 2010.

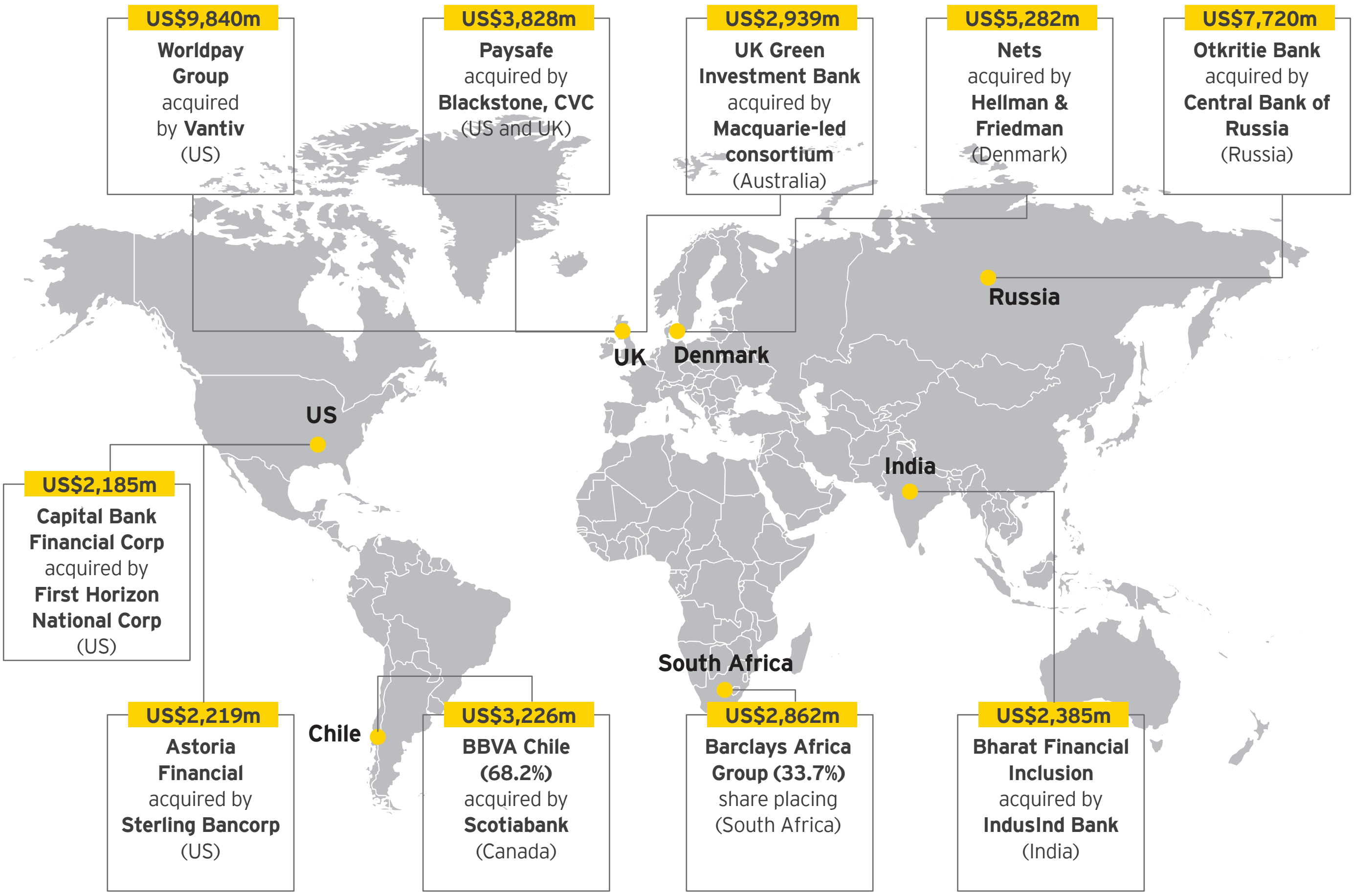
Compared with 2016, there was a 16% decline in the number of deals, and an even sharper 30% drop in total deal value – primarily a result of fewer large deals in 2017.

The global payments segment was particularly active, recording three of the top five largest deals in 2017.

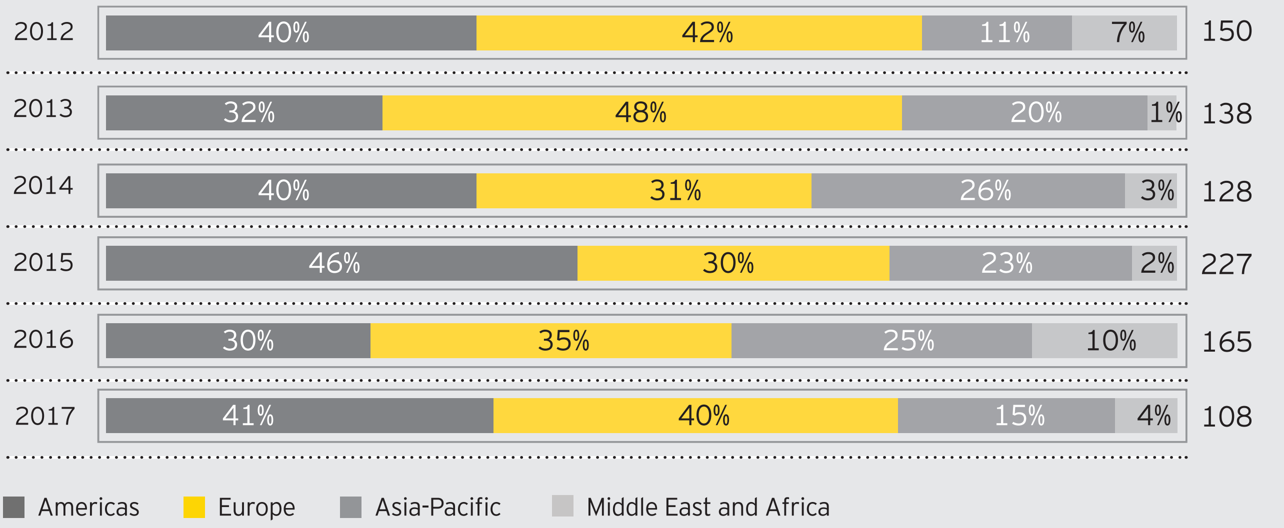
At a regional level, the Americas recorded a slight increase in deal volume. In contrast, Europe and Asia-Pacific saw a significant drop in the number of deals and deal value.

On a more positive note, the mid-market (US$500m–US$1b) was increasingly active – almost double the number of deals compared with 2016.

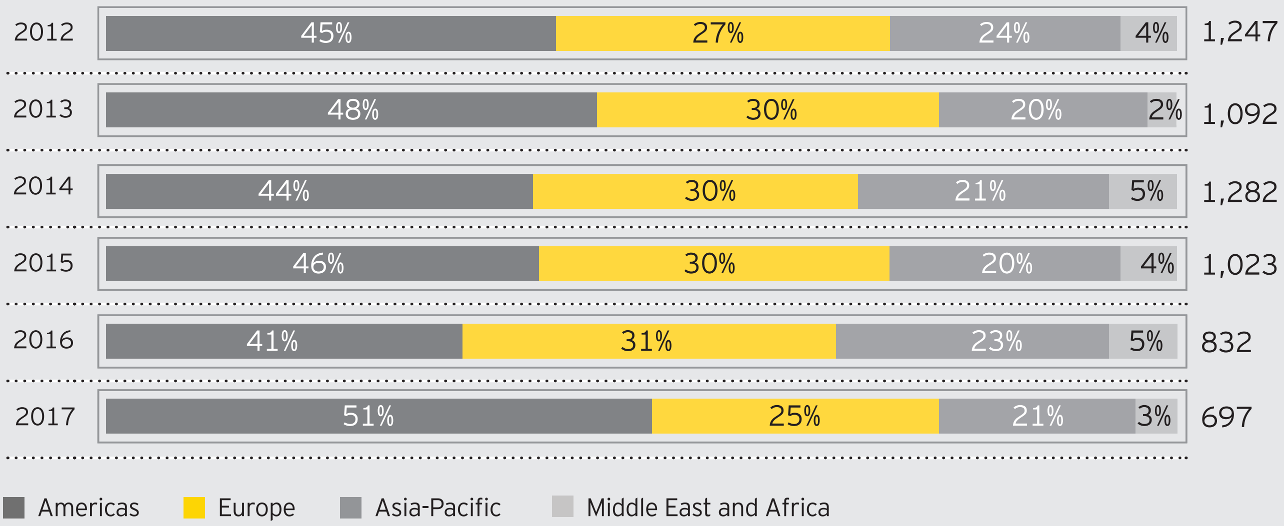
Top 10 deals in 2017



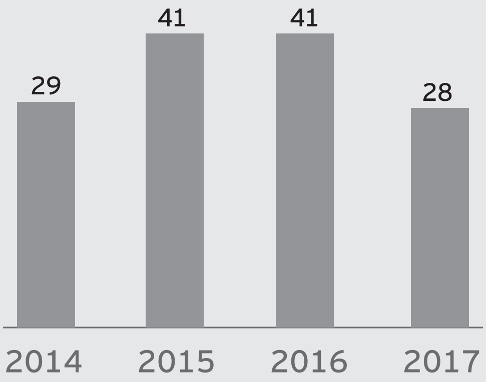
Deal value (US$b)



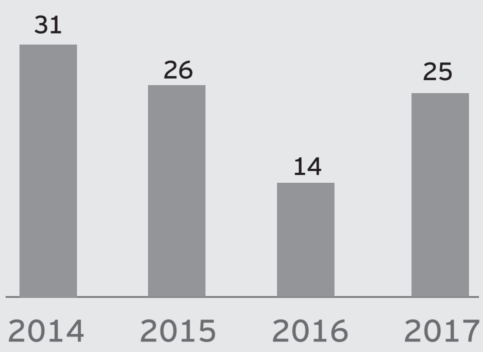
Deal volume



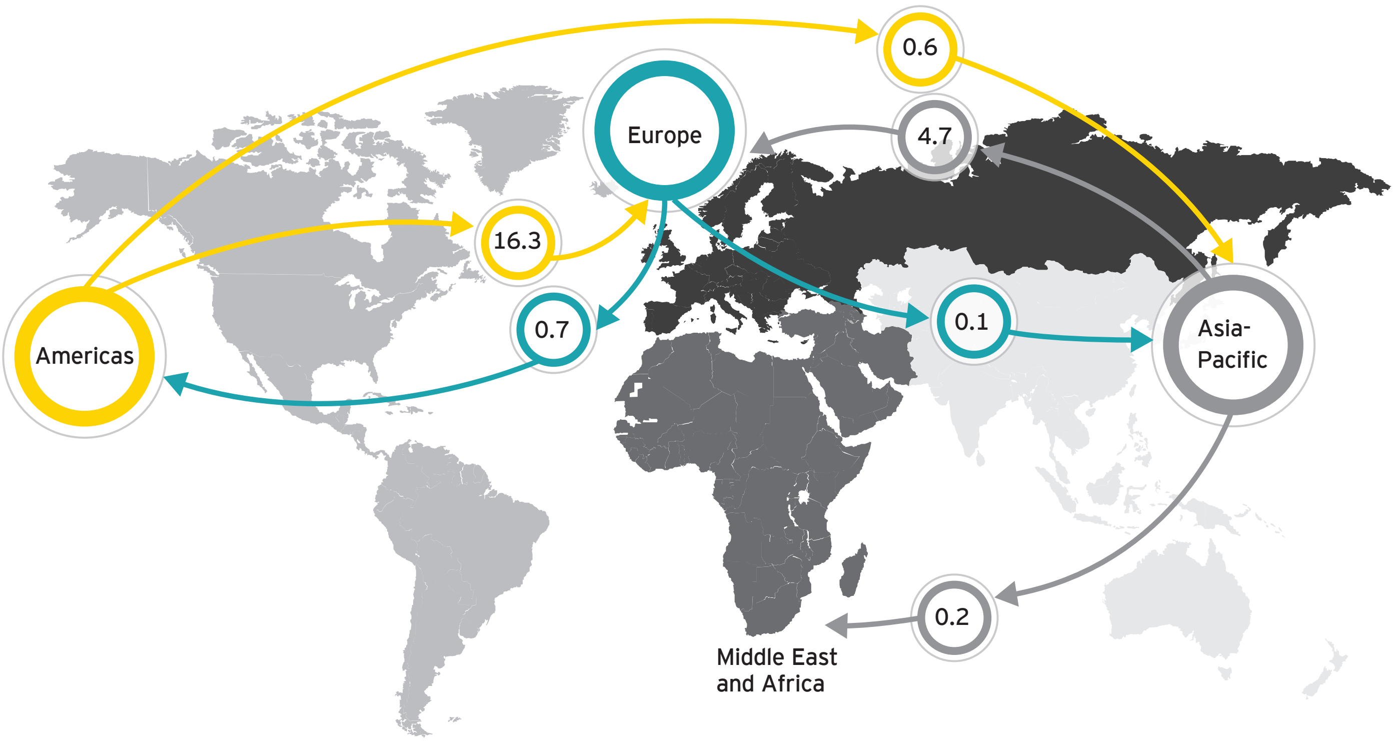
Large deals (US$1b+)



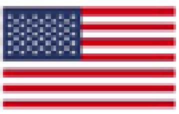
Mid-market deals (US$500m–US$1b)



Global deal flows (US$b)



Top acquiring nations in 2017 (by value)



US
33%

Canada
7%

Australia
6%

Top investment destinations in 2017 (by value)

UK
36%

Canada
10%

Chile
7%

Key takeaways

The value of global cross-border M&A activity increased by 5% in 2017, driven primarily by the inbound acquisition of European payment companies:

- Underlying this trend, four of the largest five deals in 2017 were cross-border, with a total deal value of US$22b.
- The UK sealed its position as the top investment destination, following the inbound acquisitions of WorldPay and PaySafe.

Insights from our *Global Capital Confidence Barometer*

Mergers, acquisitions and alliances are in the spotlight as a positive market outlook and digital transformation supports the improving deal market and growing deal pipelines.

Buoyant economic outlook

94%
see the M&A market as improving or stable.

92%
see the global economy as improving or stable.

41%
intend to pursue acquisitions.

Dealing with digital disruption

67%
take proactive measures to counter the impact of digital transformation.

40%
are developing digital capabilities in house; 32% are buying and forming alliances or creating JVs with digital companies.

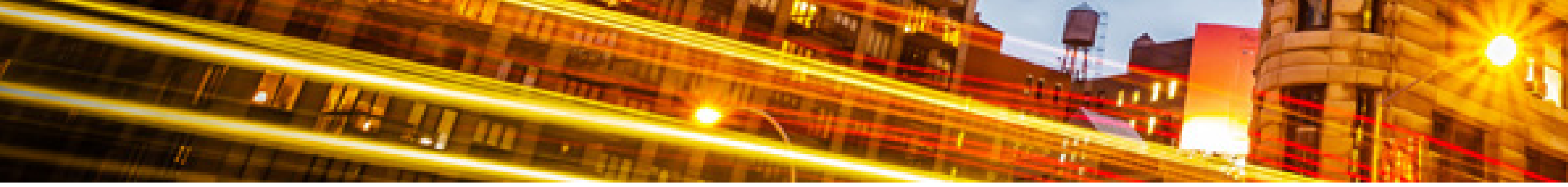
53%
are developing corporate VC arms to drive better access to new capabilities and technologies.

Need for inclusive growth strategy

88%
expect the number of companies impacted by shareholder activism to increase or stay the same.

49%
of companies expect increasing competition for assets from PE.

38%
recognize the need to ensure they have a broader narrative to engage all stakeholders.



Americas: M&A year in review

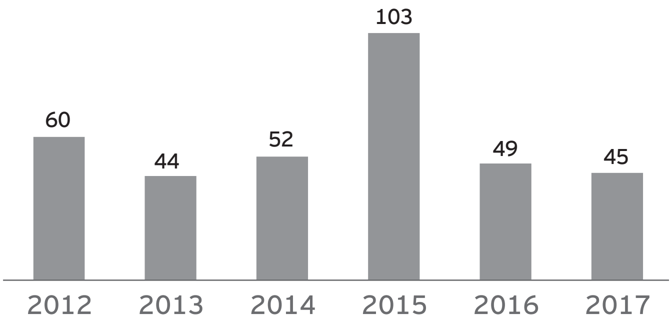
2017 highlights

8% decline in deal value compared with 2016

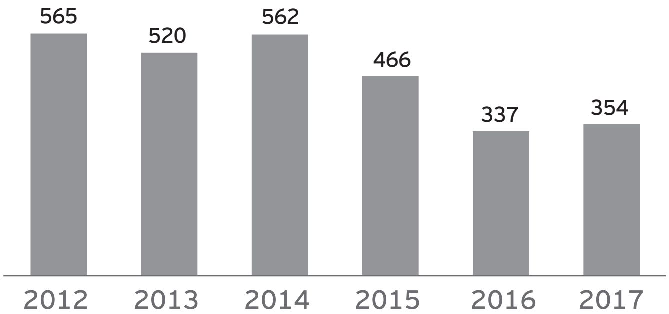
5% increase in deal volume compared with 2016

US$16.9b of outbound deals originating in the Americas in 2017

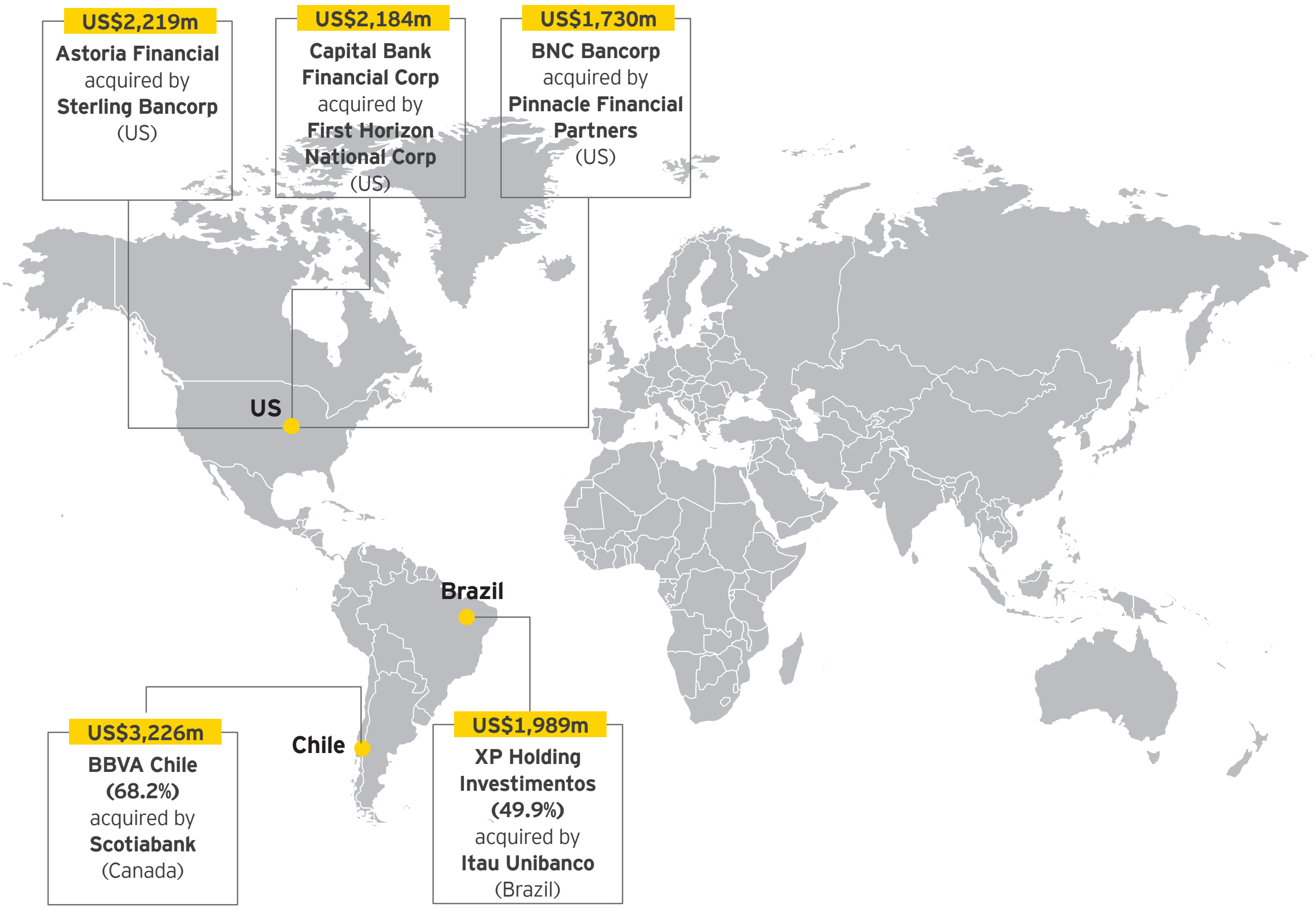
Deal value (US$b)

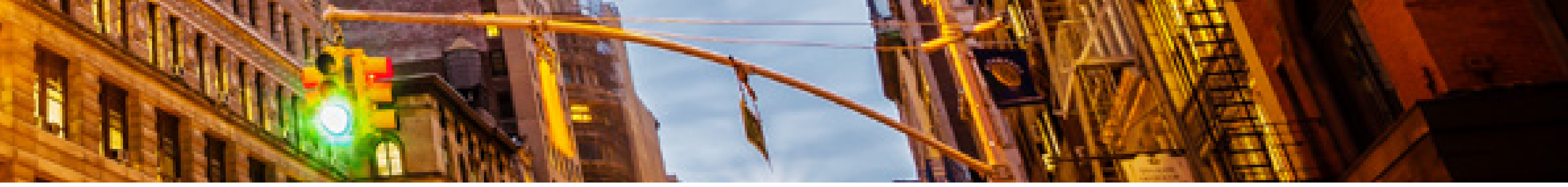


Deal volume



Top five deals by disclosed value in 2017





Americas: looking ahead

Outlook 2018

Retail banks	‣ After many years of focusing on regulatory compliance and reshaping their business models, banks are now pivoting toward growth. Even with the focus on growth, banks will still undertake regular portfolio reviews. ‣ Inorganic growth, going forward, will be focused on opportunities to grow market share, diversify business mix and geography, and increase scale to offset compliance and technology spend. ‣ US tax reform will provide an impetus to M&A activity, as higher earnings and enhanced capital ratios will give banks the flexibility to pursue growth through M&A. ‣ Regulatory relief could provide opportunities for midsized banks to merge without the fear of incurring the increased costs associated with higher total asset thresholds. ‣ Valuations between larger and midsized banks have narrowed, allowing acquirers to hunt for larger deals, although a large merger of equals is likely still constrained by regulatory pressure. ‣ Higher interest rates are seen as a positive for money center banks and this higher net interest margin will be used for potential acquisitions.
FinTech	‣ Payments is one of the most active segments of the M&A market, and we expect to see further activity and consolidation in 2018. ‣ The marketplace lending segment could also face consolidation pressures to offset increasing customer acquisition costs. ‣ Banks will continue to innovate through collaborating and acquiring FinTech companies. However, many of these deals will continue to be small transactions in terms of deal value. ‣ Mature FinTechs are likely to seek growth by acquiring in overseas markets.
Increased interest from PE buyers	‣ With increasing levels of dry powder, PE investors are actively scouting for targets across all segments within the banking sector, with a particular focus on both specialty finance and payments. ‣ Within the US, there is still some caution around PE investing in consumer lending or balance sheet businesses. However, this could change if the regulatory environment becomes more favorable.
Mortgage banking	‣ M&A will be the primary driver of long-term growth in a market facing stagnating volumes. ‣ Mortgage companies are looking for ways to remain competitive while navigating challenges, such as the interest rate environment and potential disruptions from FinTech companies. ‣ Stronger companies will look at dips in volume and market activity to acquire at a lower price, and work to leverage their platform and maintain efficiencies.

Europe: M&A year in review

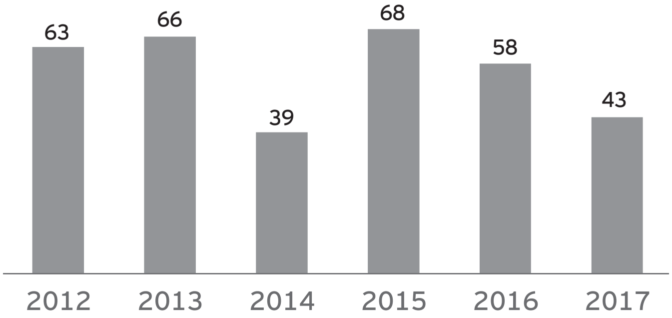
2017 highlights

25% decline in deal value compared with 2016

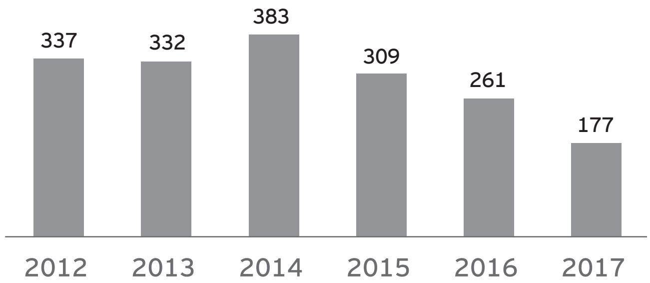
32% fall in number of deals compared with 2016

US$21.0b of inbound deals into Europe in 2017

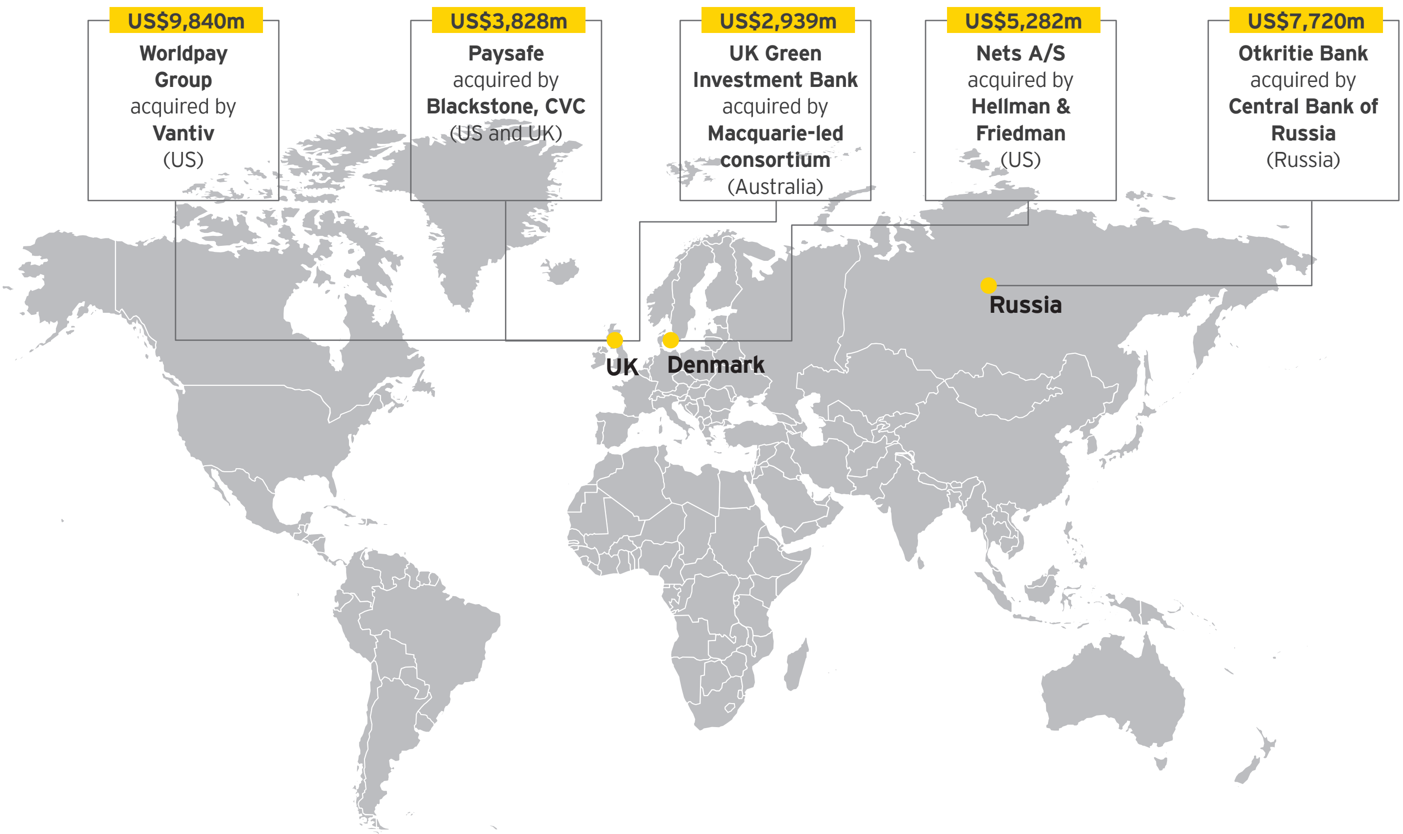
Deal value (US$b)

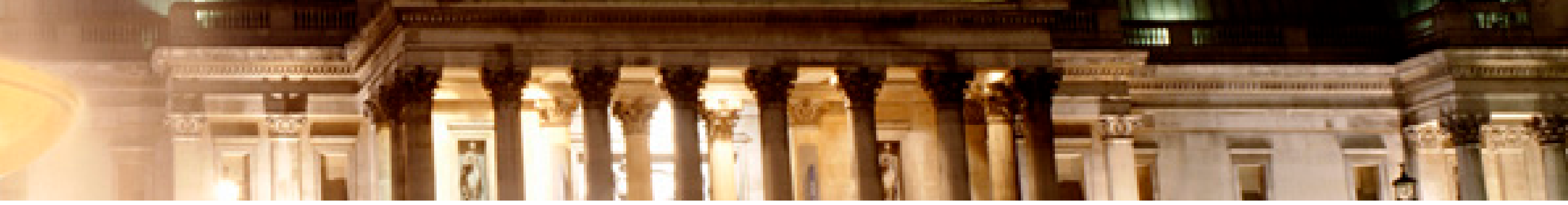


Deal volume



Top five deals by disclosed value in 2017





Europe: looking ahead

Outlook 2018

Focus on growth along with efficiency improvement

- Banks' successful implementation of M&A and partnership strategies will be key to remain competitive and win market share in attractive market segments, particularly payments and specialty finance. Alliances and collaborations with FinTech players will be instrumental in launching new products and services at a faster pace and filling the talent gap.
- In parallel, European banks are looking to improve financial performance through efficiency initiatives such as process automation. Alliances and consortiums will also play a critical role in reducing costs (blockchain consortiums, utilities, etc.).

Brexit and regulatory challenges

- Global banks with substantial operations in the UK are seeking solutions to define their future in the European Economic Area. The UK's exit from the EU will lead to strategic restructurings and relocation by banks. However, final decisions will be contingent on the outcome of the negotiations between the UK and the EU.
- The European Banking Authority's next round of stress tests is scheduled for 2018. While the broad methodology remains unchanged, the impact of International Financial Reporting Standard (IFRS) 9 could make the tests more effective as the new reporting regulation requires higher provisioning and better disclosure on NPLs.
- Upcoming financial reforms, such as Markets in Financial Instruments Directive (MiFID) II, General Data Protection Regulation (GDPR) and Payment Services Directive II (PSD II), are prompting banking & capital markets players to rethink their banking infrastructure. Banks are likely to face increased competition and compliance costs, which will drive consolidation in the European banking industry.
- New regulations have increased demand for regtech solutions as banks look for fast, cost-effective and modular compliance solutions to solve specific regulatory challenges. This will lead to investments in or purchases of regtech companies.

Noncore sell off

- Financial institutions will continue to deleverage, particularly in response to recent regulatory pressure from the European Central Bank regarding exposure to NPLs.
- State-aided bank restructuring will continue to generate M&A flows, both from noncore asset rundown and governments seeking to off-load their stakes.
- Loan sale activity will remain robust with PE and alternative managers dominating the buyer landscape.

Government-aided bank restructurings

- Some European countries, including Italy, Spain and Greece, have been dealing with troubled banks. Governments in these countries have led a number of successful bank restructurings, including Intesa Sanpaolo's acquisition of Veneto Banca and BP Vicenz in Italy and Santander's acquisition of Banco Popular in Spain.
- We expect the rescue of troubled banks to continue in Southern Europe as challenges related to economic growth and the slow revival of banking sector persist.

Active investment by PE firms

- PE players have been actively investing in the European financial services industry in the years since the financial crisis, filling the gap left as strategic investors retreated to the sidelines.
- PE houses have become proficient at purchasing and managing NPLs from European banks. Several firms, including Anacap, Fortress, Intrum Justitia, Quaestio Capital Management SGR SpA and Bain Capital, have bought European NPL portfolios in 2017 with extensive activity in Italy and Spain.
- The payment processing space has attracted considerable interest from PE firms in recent years. In 2017, Blackstone and CVC Partners acquired PaySafe, while KKR sold First Data Baltics to Worldline.
- PE investment trends are expected to continue given record levels of dry powder at PE firms, digital disruption in banking and continued de-leveraging in Europe. Strategic investors will face strong competition from PE houses, particularly in niche banking areas, which will lead to higher valuations for assets.

Central and Eastern Europe (CEE) consolidation

- Banks in CEE are consolidating as they seek to improve operational efficiency. The regulatory environment and ongoing pressure on profitability will likely accelerate this trend, particularly for smaller banks in the region.
- As has been the case in other parts of Europe, increased activity related to NPL portfolio sales in CEE will attract the interest of PE players.

Asia-Pacific: M&A year in review

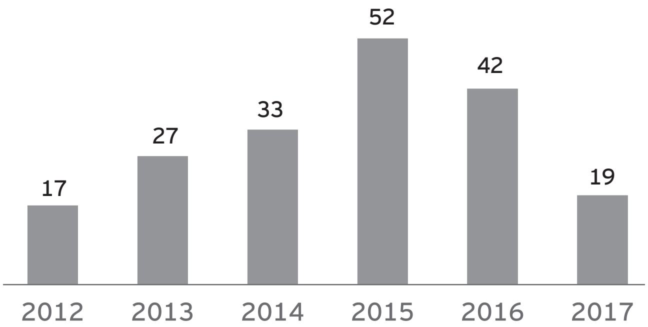
2017 highlights

61% decline in deal value compared with 2016

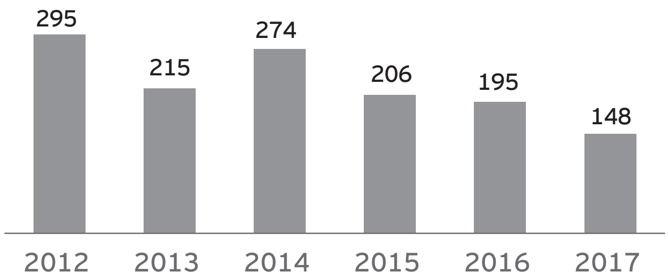
24% decline in number of deals compared with 2016

US$4.9b cross-border outbound deals in 2017

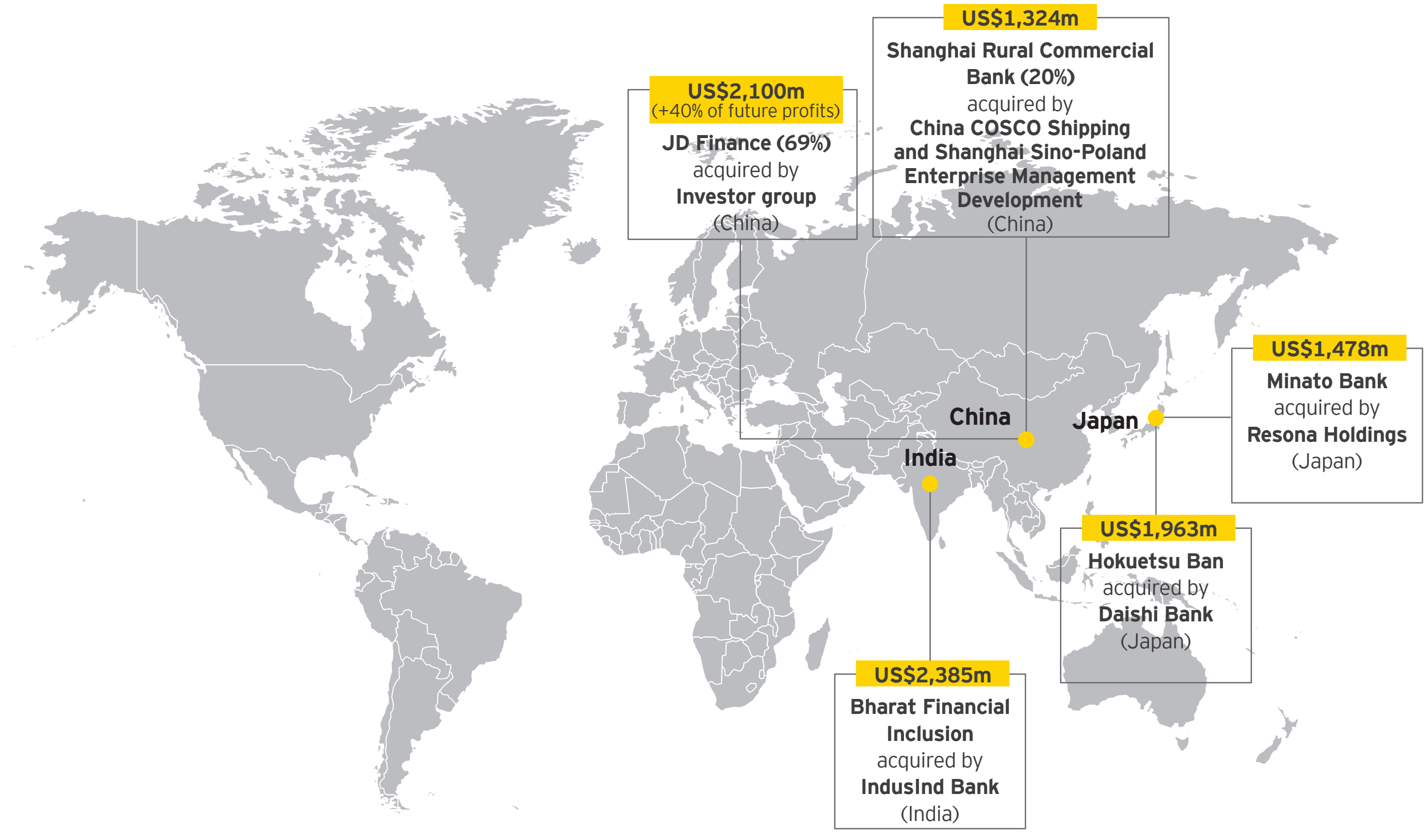
Deal value (US$b)



Deal volume



Top five deals by disclosed value in 2017



Asia-Pacific: looking ahead

Outlook 2018

Asia to remain focal point for digital and FinTech activity

- The search for new markets will drive cash-rich Chinese FinTech firms to look for collaboration and investment opportunities outside of their domestic market.
- Technology-enabled platform companies across a number of sectors, backed by the likes of Tencent, AliPay and JD.com, are aggressively investing in mobile payment companies across Southeast Asia.
- FinTech investments in India, South Korea and Indonesia are set to increase, driven by increasing levels of digital adoption and a regulatory push toward digital and innovation. Meanwhile, the FinTech hubs of Sydney, Singapore and Hong Kong will continue to attract global investment and talent.
- Banks will continue to look for opportunities to collaborate and invest in innovative FinTech companies to help them develop new products and deliver an enhanced customer experience to their clients.

Digital banks

- The Hong Kong Government is encouraging the creation of a new cadre of digital-only banks with new regulation that will allow nonbanks to enter the lucrative and FinTech-savvy consumer market.
- We expect that this will increase competition for customers across the most profitable product categories.

Change in foreign bank rules in China to boost investment activity in mainland

- To increase the competitiveness of its banking sector, China has changed its laws to allow foreign players to own 51% of their mainland JVs. This is expected to provide some impetus to inbound M&A activity into the country.
- The rules are expected to have a greater impact on second- and third-tier banks where capital is required and partnerships may prove mutually beneficial. We don’t expect to see much of an impact on larger tier-one banks given their scale and their limited demand for outside capital.

Strengthening capital positions through sale of noncore and nonperforming assets

- Banks will continue to exit noncore operations, including their life insurance and wealth management businesses. This trend has been particularly prevalent across Australian banks in 2017, and should continue throughout 2018.
- The issue of NPLs has increased, particularly in China, India and Indonesia. Regulatory drives to strengthen capital positions, along with any slowdown in domestic markets, could further impact the already fragile capital positions of banks in these economies. In response, we will likely see banks stepping up their efforts to sell NPLs and raise equity to strengthen their balance sheets.

Increased interest from PE

- We have seen an increasing appetite from PE to invest in the nonbank financial services sector across the region, particularly within consumer finance, microfinance and payments. With high levels of dry powder, we expect to see PE become more aggressive in 2018.

EY advantage

Financial services organization overview

EY maintains a dedicated financial services organization that has provided excellent services for clients across three of our industry sectors: banking & capital markets, wealth & asset management, and insurance.

Dedicated financial services focus

- EY maintains a team devoted to working exclusively on financial services transactions that brings together all the necessary industry- and transaction-specific competencies required throughout all phases of a deal.

Knowledgeable financial services professionals with informed transaction methodology and approach

- Our proven transaction professionals are dedicated to the financial services sector and are knowledgeable of industry specific challenges.
- EY Transaction Advisory Services (TAS) is continually refining our methodology based on industry deal experience that can be adapted to meet specific client needs and accelerate deal execution.

Utilize a collaborative approach to deliver holistic capital strategies

- EY TAS helps clients execute on all aspects of their transaction strategies in their capital life cycle, including raising, optimizing, investing and preserving capital in order to realize growth and profitability goals.

Proven ability to provide excellent services on financial services transactions

- Our teams have advised clients across all financial services sectors in achieving desired business objectives through the execution of various deal types (e.g., M&A, carve-outs, tax-free spins, JVs, IPOs), and these experiences allow us to help others navigate potential pitfalls.

Client value

TAS can help you prepare for a transaction from beginning to end to achieve the following key deal objectives.

Preserve and enhance value

- Our teams use deal experience to surface issues that destroy deal value so that they can be addressed protectively.
- Our financial services transactions professionals are able to assist clients in articulating, preserving and capturing shareholder value across all deal types.
- EY financial services integration and separation professionals know how to navigate execution pitfalls that can prolong the deal process or create undue exposures.

Designed to increase deal success

- Our teams use a leading-class integrated approach that combines strategy, financial due diligence, operational due diligence, and integration and separation planning and execution to increase deal success.
- EY teams with EY clients to enhance their internal competencies by applying scalable, repeatable and disciplined approaches to separation and integration processes.

Reduce disruptions and capture deal value

- EY assists clients in implementing a swift and disciplined approach that allows for the realization of deal synergies through focused planning, prioritization and execution of strategic initiatives.
- Teaming with EY on transactions allows executive management to maintain the necessary focus on running the day-to-day business instead of becoming to absorbed in transaction-related commitments.
- Additionally, leveraging EY's depth of transaction competencies frees up capital and resources that EY clients can apply toward other strategic business priorities.

Enhanced credibility

- Our transaction teams support management to be well prepared for deal negotiations by surfacing critical information through rigorous due diligence procedures.
- EY's proven track record also benefits EY clients by exhibiting to involved counterparties the quality of experience and effort that is being applied to the transaction process.
- EY clients also reap the reputation benefits of completing a well-executed deal.

EY is the only Big Four firm with a fully dedicated Financial Services organization specifically designed to broadly address the unique issues of the banking and financial services industry.

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