Banking and Capital Markets: Top Trends for M&A in 2016

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Did our 2015 predictions come to pass?

1	Narrowing pricing gaps in Asia
2	Japan continues to look outward
3	US activity remains robust
4	Focus shifts south
5	M&A drives growth for stronger institutions
6	Funds activity heats up
7	Continued restructuring and loan sale activity
8	Bancassurance shifts to high growth markets
9	Private Equity goes on the hunt
10	Competition rises for Financial Technology

Prediction realized
Prediction partially realized
Prediction not yet realized

Foreword

2015 was an interesting year by all accounts in the banking sector globally and in particular for M&A activity in the sector. Deal value was up significantly over 2014 and while the level of activity was foreseen by many, the specific nature of what took place varied over many expectations. The level of anticipated activity in parts of Asia was mixed with outward investment continuing to be robust but not perhaps at the level that some had anticipated as market signals in China in particular were largely negative after the midpoint of the year. In contrast, Japanese M&A activity in Financial Services (FS) was even stronger than anticipated with key acquisitions such as RBS and GE highlighting the pattern. Surging interest in investment in fintech and alternative finance was higher than expected in 2015 by many and has raised questions of a bubble for the year ahead.

For our part we believe 2016 will see significant extension of many of these trends along with some level of retrenchment and consolidation in specific markets. It is doubtful whether we have reached the inflection point from bear to bull with the major European banks, but they are expected to progress further on the road to recovery in 2016. At the same time we expect the emergence of new patterns of behavior in key areas such as wealth management and global loan portfolios that promises to reach a much broader geographic base in the year ahead.

Overall the view from KPMG's global network of deal savvy FS leaders is that 2016 will be a significant year of growth and opportunity in financial services and that the scope of the key trends has actually become more diverse than in years past. As a result our list grows from 10 to an even dozen in 2016 and consequently an even more valuable resource to FS executives needing to focus on making the right strategic choices for their own needs in a highly diversified but competitive global market.

Stuart Robertson
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Top Trends for M&A in 2016

Trend 1

M&A set to increase in 2016

Deal volume for banking and asset management increased by 20 percent in 2015; however deal value surged by a staggering 70 percent[1]. In 2015, we saw several large financial business disposals by GE Capital and significant activity in the leasing space. We expect overall deal activity to continue to increase in 2016, specifically with regards to Asian, and Japanese banks being in buy mode, US regional banks consolidating, continued non-core sales by European and the United States (US) banks, the booming fintech sector and restructuring of banks in commodity-driven emerging markets. As in prior years, we expect pre-dominance of domestic deals followed by equal proportion of regional and intercontinental deals.

> "Japanese banks will be in buy mode."

[1] Source: Mergermarket and KPMG analysis.

Trend 2

Asian and, in particular, major Japanese banks on buying spree

Large Japanese financial institutions are expected to remain one of the most active groups of buyers in 2016. They were extremely active last year and this trend is expected to continue. Key 2015 Japanese deals were the acquisition of RBS's North American loan portfolio commitments of 36.5 billion United States dollars (USD) by Mizuho Bank Ltd for USD3 billion[2] and the acquisition of GE Capital Corporation's European Sponsor Finance business by Sumitomo Mitsui Banking Corporation Europe Limited for USD2.2 billion. Even though the large Chinese banks reported modest deal activity in the last two years, strengthening their global footprint remains a key part of their strategy. We predict a certain sustained level of activity with Chinese banks in 2016 albeit somewhat depressed by current market conditions but remain convinced it will pick up strongly in the long term. Banks in other Asian countries such as Singapore and Indonesia will look for deals to become regional players.

[2] Source: Mizuho acquires RBS North America loan assets for $3bn. http://www.ft.com/cms/s/0/6993617e-bd6b-11e4-b523-00144feab7de.html#axzz3zJBFPs7H

Trend 3

US SIFI banks remain bearish on M&A; superregional banks will leverage scale to achieve consolidation

Large United States (US) Strategically Important Financial Institutions (SIFIs), preoccupied with regulation and restructuring in the past few years, have been effectively inactive on the deals front. This trend is expected to continue and we do not expect the major US banks to be bold in M&A, whether global or domestic. Any deal activity is likely to be close to their core business and bolt-on in nature, as well as select divestitures of non-core or capital inefficient businesses. Expansion into low capital intensity fee-based business (e.g., asset and wealth management, advisory services, etc.) is expected. Taking advantage of this environment, we expect substantial activity among superregional banks leading the consolidation wave, as they seek to transform from regional into national players.

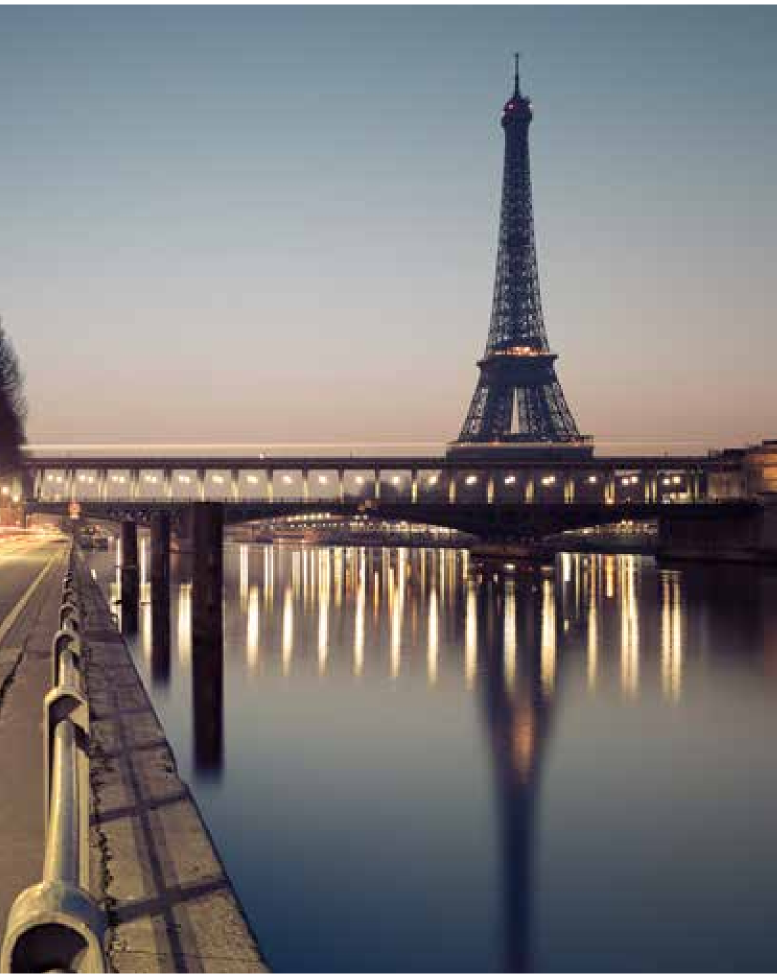
Trend 4

US and Europe in 'simplify' mode — sell side focus

As a direct result of evolving Basel requirements, and business models being the European Central Bank's (ECB's) top supervisory priority for 2016, we are seeing a further simplification in the business models of European and North American banks. The introduction of risk-weight floors for asset types including mortgages will further strain weak margins, rendering some mortgage banks unviable. This is likely to drive consolidation of regional banks, particularly in Italy and Germany, to achieve economies of scale. Banks will continue to reduce their complex and capital intensive assets (e.g. leasing) and move towards low-risk weighted balance sheets. The focus will be on business simplification, operational efficiency and shedding/managing capital intensive activities. These developments will give rise to a stream of non-core disposals, outsourcing of activities and the creation and hive off of utilities. As a result, the return on equity of banks is expected to increase marginally in 2016. It is doubtful whether this will be a point of inflection for the industry but certainly another step in the road to recovery.

Trend 5

French banks have the most appetite to buy among European players; European banks expected to be active with bolt-on and portfolio acquisitions; watch Italy



Amongst the top European banks, French banks were most acquisitive in the last year. Key deals were the acquisition of Sharekhan Ltd (a securities broker and an investment advisor) by BNP Paribas (USD343 million)[3] and acquisition of a 21 percent stake in Boursorama SA (an online banking service provider) by Societe Generale SA. Credit Mutuel has announced the signature of a MoU for the acquisition of the French and German factoring and leasing business of GE for 6.6 billion euros (EUR). Other major Western European banks such as HSBC, Barclays, Deutsche Bank, UBS and Credit Suisse were less active throughout the year; however we expect a tentative return of these banks to bolt-on and portfolio acquisitions, potentially in partnership with private equity as these firms extend further into building balance sheet businesses as well as 'traditional' activity. For example in 2015, KKR & Co. L.P., Varde Partners, Inc., and Deutsche Bank AG signed a definitive agreement to acquire GE Money Australia and New Zealand, from GE Capital Corporation for USD917 million. Finally, Italy should be on the radar as a sell-off of Italian banking shares hits the market.

[3] Source: BNP Paribas to acquire Sharekhan Limited. http://www.bnpparibas.co.in/en/2015/07/30/bnp-paribas-to-acquire-sharekhan-limited/

Trend 6

LATAM — challenging landscape and opportunities for regional banks

More regional players are expected to emerge in 2016 and beyond. Recent exits by international players (such as Citi, HSBC and Deutsche Bank) owing to economic uncertainty in the region and non-core decisions is giving rise to the emergence of regional and local champions. Market dynamics vary vastly from stable and booming (Mexico, Colombia, and Peru) to depressed (Brazil, Southern cone). Argentina is on the radar given the recent political changes.

> " More regional players are expected to emerge in 2016. "

Trend 7

Central and Eastern Europe — coming back on the map

Overall, deal activity in the region was light to moderate in 2014 and 2015 with average deal value of about USD3 billion per annum. In the last two years, Poland, Hungary, and Austria were the most active deal-making countries. We expect increased deal activity in the region as several Central and Eastern European countries have taken measures to clean up their banks' balance sheets. Foreign players are expected to exit from certain Central and Eastern European markets such as Czech Republic, Hungary and Bulgaria due to strategic refocus of operations and geographies. Moreover, we will see stronger PE activity in the region and loan sales picking up as banks continue to address their non-performing loan exposures.

Trend 8

Africa — surge in financial inclusion — weak economic conditions to weigh down Africa's M&A trajectory

The increased adoption of mobile technology is likely to continue to drive financial inclusion in 2016. Banks have renewed their focus on digitization with increased emphasis on cost and capital optimization to maintain profitability. However, asset quality deterioration due to weak commodity prices, currency depreciation and structural challenges continue to remain a headwind for African countries. From an M&A perspective, we expect to see capital raising activity in countries like Nigeria and Kenya and among few regional banks that are looking to sell a stake to strategic or financial investors. Some foreign banks may exit from certain parts of the region following the weak investor confidence shaken by stressful economic conditions; while few might scale up in certain business segments.

> "We expect to see capital raising activities in countries like Nigeria and Kenya."

Trend 9

Fintech – will the bubble burst or will brutal disruption accelerate?

In 2015 global FinTech investment topped USD20 billion[4]. We expect fintech M&A to continue to grow as high as USD30 billion[5] in 2016 with many predicting brutal disruption to banks as new technologies and players enter the market. We expect to witness more joint ventures and eco-system related deals involving multiple counterparts such as exchanges, regulators, clearing houses etc., as competitors become partners. The highest deal activity in 2015 was in payments space. Major deals included PayPal acquiring Paydiant (a payments startup that licenses a technology platform used by large retail chains), Optimal Payments acquiring Skrill (an e-commerce business that allows payments and money transfers) and Worldpay's (a payment processing company) IPO of 4.8 billion British pounds (GBP) on the London Stock Exchange. Payments will remain an attractive area as it has the highest adoption rate for disruptive technology compared to other FinTech services. In addition to the payments sector, these digital startups will continue to further accelerate the creation of utility businesses and FinTech related solutions resulting in the evolution of an open source architecture within the banking sector. In 2016, these startups will continue to seek banks as partners, some of them will be acquired by their partner banks; while a few banks will set up their own FinTech venture capital funds such as Santander Innoventures. Also, high valuations of FinTech startups (P/E multiple ranging 10x-26x and EBITDA multiple ranging 12x-16x) and their sustainability will be a key area to watch. We do not expect FinTech valuations to adjust this year; however, we will see shift of focus to Blockchain as it is rapidly becoming a crowdsourced system reducing the redundancy and delays that exist in today's banking system. We will see further investments in this technology as banks have joined with FinTech startup 'R3CEV LLC (R3)' to develop a framework for using Blockchain technology in financial markets. As long as FinTech brings genuine customer benefit, we do not expect the bubble to burst.

[4] Source: H2 Ventures KPMG Fintech 100 – Announcing the world's leading Fintech innovators for 2015. https://home.kpmg.com/xx/en/home/insights/2015/12/ventures-kpmg-fintech-fs.html

[5] Source: Forget a fintech bubble: 2016 will be the year this booming market finally gets serious. http://www.cityam.com/230876/forget-fintech-bubble-2016-will-be-year-booming-market-finally-gets-serious

Trend 10

Top of asset managers' agenda – growth and operational leverage

We saw an uptick in activity in the asset management sector driven in part by the inevitable consolidation in a very fragmented industry, the search for growth through diversification and the desire to capture capabilities. We expect to see similar themes in 2016 but perhaps strengthening as competition heats up. Distribution, product, geographic diversification as well as capability build will continue to be the key drivers for M&A. We also expect Exchange Traded Funds (ETFs) to continue to see strong growth which is likely to further drive many managers to turn to the development of ETF propositions.

Trend 11

Emergence of global loan portfolio business; increasing diversification of traditional loan portfolio buyers

We expect a swift shift in the deleveraging and restructuring of business activities from Ireland and Spain to Italy and Greece. Loan sale activity in Europe will remain high for the next two years. Spain will continue to be active as activity in the United Kingdom (UK) and Ireland is expected to subside. Activity has already increased in Central Europe (Romania, Hungary, and Poland) and there is expected to be an increase in activity in Italy. In Asia, China is now a very active loan sale market and potentially will be larger than Europe over the next five years. In addition, there is huge potential in both India and Indonesia for both markets to develop substantially. In LATAM, there is now a steady flow of activity in Brazil and this market is expected to explode over the next 24 months.

Bank deleveraging will continue given the quantum of Nonperforming Loans (NPLs) and need for more efficient bank balance sheets continues. Recently opened NPL markets are evolving to service smaller (e.g. residential mortgage NPLs in the UK), more granular (e.g. shifting from corporate to Small Medium Enterprises (SMEs) in Ireland) and more varied assets classes (e.g. commercial real estate debt in Italy) in existing markets, and buyers are shifting their attention to higher yielding (e.g. Greece) and less competitive markets (e.g. India). Further, many established players are using increasingly favorable financing packages from predominantly US and local banks, to buy and build more traditional banks and lending businesses. This has been particularly evident in stronger (e.g. Australia), recovering (e.g. Spain) and Mortgage-Backed Security (MBS) experienced (e.g.: the UK and the Netherlands) markets, where private equity sponsors can provide sellers of performing loans and businesses with strong pricing, often on par or in excess of strategic purchasers.

Trend 12

Insatiable demand for wealth management business

We saw many wealth management deals during 2015 such as Union Bancaire Privée (UBP) acquiring Coutts International from RBS and Towry's acquisition of Ashcourt Rowan. Wealth management M&A is expected to further accelerate into 2016 resulting from a confluence of regulatory pressures, evolving technology and a more competitive landscape as major drivers. The drive for differentiation, growth, digitalization, distribution and innovation will be key to banks better engaging and remaining relevant. Wealth management is starting to become disrupted by technological innovation and we will continue to see the same trend in year ahead. The rise of robo-advisers, including nutmeg and a whole host of new digital entrants is posing a threat to the traditional industry incumbents. Moreover, we expect to see continued high private banking activity in Switzerland as the consolidation of the 130 private banks accelerates. Asian wealth management sector is also likely to see further consolidation as smaller players find it harder to offer the range of services demanded by the wealthy and affluent clients. We observe that wealth in the region is expanding but the business of managing it is flowing out to the large asset managers who have attained a certain size and are able to provide differentiated services. Thus, smaller firms are likely to be forced to consolidate their business. Demand for targets will continue to outstrip supply.

> "Wealth management is increasingly being disrupted by technological innovation."

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