Financial Services Sector

Dealtracker

Providing M&A and PE deal insights

Introduction

Even after the end of first half of the calendar year 2023 uncertainty around the sector persists. Inflation continues to be sticky in most countries primarily due to unchanged external macro-economic circumstances – the Ukraine conflict, Sino-American rivalry and the post-pandemic slowdown in China to name a few. This has resulted in supply-side issues in delivery of goods and services, leading to high inflation. Central bankers have no choice, but to respond aggressively to control spiralling inflation.

Inflation is a demon that can cause economic and social instability and reduce the growth prospects of a country in a very short period of time. Therefore, it needs stringent measures such as interest rate hikes, which is adopted by Central bankers globally. This has significantly escalated conversations on **"funding winter"** across the fintech ecosystem globally. Higher interest rates have lowered valuations and have also increased the focus on profitability across various organisations.

The investors have become far more choosy about the kind of investments that they are making and have also heightened oversight over their existing investment portfolio, to address strategic issues that will help prioritise cash flow earnings over wasteful customer acquisition costs.

However, the story in India is a positive one due to political stability, series of economic and financial reforms related to market infrastructure, regulatory and operations, a substantial market as a result of a large population and demographic dividend, since the population is young. Like the US, the UK, Europe and Australia, India continues to experience high inflation. However, of late the Consumer Price Inflation numbers seem to have reduced and come within the inflation tolerance band of the Reserve Bank of India (RBI), resulting in the RBI not increasing the interest rates in its latest bi-monthly monetary policy in the first week of June 2023.

The deal activity in the April-June 2023 quarter reflects the story of Indian growth. Investors, primarily the Private Equity and the Venture Capital Investors, believe that the growth in the Indian economy will come from providing credit to the underserved population in the country through digital channels of delivery. Therefore, a significant amount of investments have been directed towards organisations with a digital lending focus. The recent RBI guidelines on Digital Lending have also provided clarity on the much debated First Default Loss Guarantee, thereby giving a significant impetus to the partnership/alliance ecosystem between the Fintech and the traditional BFSI segment. Hence, the segment is attracting more investments.

We expect the global interest rates to taper off by March 2024, and expect the exuberance in investing activity to be back globally. However, we hope that the key lessons on business fundamentals and profitability for investors continues to be an area of focus, even in an exuberant external environment.

Deal snapshot

Q2

Deal summary	Volume				Value (USD million)			
	2021	2022		2023	2021	2022		2023
Domestic	9	9		10	5,152	40,173		46
Cross-border	0	3		1	0	1,653		5
Total M&A	**9**	**12**	↓ 8%	**11**	**5,152**	**41,826**	↓ 99.8%	**51**
Private equity	**61**	**80**	↓ 49%	**41**	**1,422**	**2,519**	↓ 8%	**2,314**
Grand total	**70**	**92**	↓ 43%	**52**	**6,574**	**44,345**	↓ 95%	**2,365**
Cross-border includes								
Inbound	0	2		0	0	10		0
Outbound	0	1		1	0	1,643		5

H1 2023

Deal summary	Volume				Value (USD million)			
	2021	2022		2023	2021	2022		2023
Domestic	24	17		18	5,660	40,326		159
Cross-border	0	5		2	0	1,832		205
Total M&A	**24**	**22**	↓ 9%	**20**	**5,660**	**42,158**	↓ 99%	**364**
Private equity	**113**	**149**	↓ 52%	**72**	**2,513**	**4,261**	↓ 21%	**3,364**
Grand total	**137**	**171**	↓ 46%	**92**	**8,173**	**46,419**	↓ 92%	**3,728**
Cross-border includes								
Inbound	0	3		1	0	177		200
Outbound	0	2		1	0	1,655		5

Financial services witnessed a steep decline in deal activity

- The financial services sector experienced a significant decline of 43% in deal volumes and huge decline of 95% in overall deal values, as compared to Q2 2022, with just 52 deals valued at USD 2.37 billion. This decline can be attributed to ongoing market volatility and high global interest rates coupled with absence of high-value transactions.
- Technological advancements and the emergence of fintech start-ups have disrupted traditional segments within the sector, leading to a decline in deal activity. Fintech companies are introducing new business models and innovative products, and catering to ever-changing customer preferences.
- In comparison to Q1 2023, there was a notable 30% increase in deal volumes and a substantial 74% increase in overall deal values in the current quarter. This growth is due to big-ticket transactions during this period. There were no deals in the billion-dollar category in Q1 2023 but had six high-value deals (worth more than USD 100 million). However, Q2 2023 featured one-billion-dollar deal and three high-value deals, leading to an increase in overall deal values.
- Mergers and acquisitions (M&A) activity in the sector reported a marginal decline of 8% in deal volumes and a significant decline of 99.8% in deal values, primarily due to the impact of the HDFC merger in Q2 2022. Domestic consolidations dominated the M&A activity, accounting for 90% of the deals in the sector.
- While Private equity (PE) space also saw declined activity, the space saw a marginal decline of 8% in deal values and a significant decline of 49% in deal volumes, driving the average deal size from USD 31 million in Q2 2022 to USD 56 million Q2 2023.

H1 2023 witnessed substantial decline with absence of major deals

H1 2023 witnessed a 46% decline in volumes and a strong 92% decline in values recording only 92 deals valued at USD 3.7 billion. This is due to one of the biggest deals in Indian history – merger of HDFC and HDFC Bank worth USD 40 billion. Excluding that deal we still witnessed a 42% decline in overall values suggesting a tepid deal making environment.

Top deals: Q2 2023

Top deals accounted for **91% of overall deal** values and constituted only **19% of volumes.**

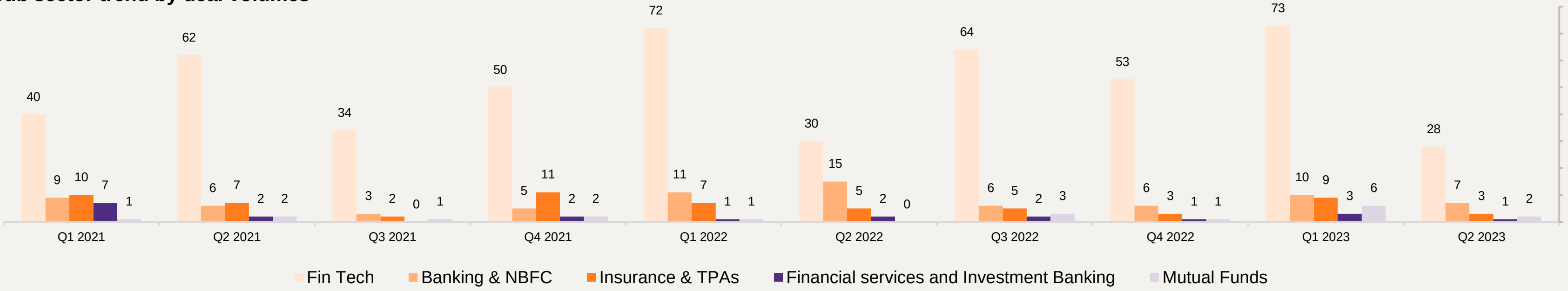
Investor/ Acquirer	Investee/ Target	Deal type	sub sector	USD mn	Stake%
BPEA EQT and ChrysCapital	HDFC Credila Financial Services Ltd	PE	Banking & NBFC	1,105	90%
Sumitomo Mitsui Trust Bank and MUFG Bank	DMI Finance Pvt. Ltd	PE	Banking & NBFC	400	N.A.
Warburg Pincus and angel investor	Vistaar Financial Services Pvt Ltd.	PE	Banking & NBFC	250	90%
General Atlantic	PhonePe Internet Pvt Ltd	PE	Fin tech	100	N.A.
PremjiInvest	TVS Credit Services Ltd	PE	Banking & NBFC	90	10%
Nuveen, FMO, a European development financial institution and Piramal Alternatives	Arohan Financial Services Pvt Ltd	PE	Banking & NBFC	89	N.A.
British International Investment, OP Finnfund Global Impact Fund I, Omidyar Network India, Flourish Ventures, CX Partners and ICICI Venture	Indifi Technologies Pvt Ltd	PE	Fin tech	35	N.A.
Accion's Digital Transformation Fund and undisclosed investors	IKF Finance Ltd	PE	Banking & NBFC	30	N.A.
Nuveen	Aviom India Housing Finance Pvt Ltd	PE	Banking & NBFC	30	33%
Investeringsfonden for Udviklingslande (IFU)	UGRO Capital Ltd	PE	Banking & NBFC	29	N.A.

Sub-sector analysis

Financial services sector witnesses dominance of fintech

- The financial services sector is grappling with challenges related to regulatory compliance, cybersecurity risks, and the need for continuous innovation to meet evolving customer expectations.
- The fintech space leads the sector, accounting for 71% of the deals, followed by banking and non-banking financial companies (NBFCs) with an 12% sectoral share in H1 2023.
- While fintech led both M&A deal volumes and values in H1 2023, banking and NBFC dominated the M&A values in H1 2022 driven by the merger of HDFC-HDFC bank.
- Fintech deals also led PE volumes while the banking and NBFCs segment dominated in terms of PE deal values. Notable investments by BPEA, EQT and ChrysCapital in HDFC Credila Financial Services totaling USD 1.1 billion, accounted for a significant portion of the segment's overall PE values. The banking and NBFCs sector accounted for 64% of the total PE values in H1 2023.
- Key regulatory reforms, particularly in digital lending with the First Loss Default Guarantee (FLDG), have stimulated investments in the digital lending space, contributing to robust deal activity in this sector.
- The interest rates have remained unchanged in the last two monetary policy announcements as inflation has stabilised within the regulatory expectations. The Reserve Bank of India (RBI) is adopting a wait-and-watch approach to assess the impact of previous rate hikes on the economy.
- The financial services sector has demonstrated impressive performance driven by digital transformation, dynamic shifts in the Indian economy, and regulatory reforms, instilling a sense of optimism for future growth opportunities in the sector.

Sub sector trend by deal volumes



Grant Thornton

Grant Thornton Bharat sector case studies (1/2)

Client Profile: A full-service commercial bank providing a complete range of products, services and technology-driven digital offerings, catering to Retail, MSME as well as corporate clients.

Situation and problem statement

- One of the bank's clients in the movie exhibition business was defaulting in its payment obligations. The business was deeply affected during the Covid-19 pandemic and could not fully recover, leading to a situation of spiraling financials and NPL status.
- The bank wanted a close oversight on the operational cashflows of the company and the areas of improvement.

Our solution

- All payments made by the company above a certain threshold were pre-approved by the GT team to ensure there are no leakage and payments to vendors are prioritised appropriately.
- The entire collections of the company was made in its account held with the client, who were also their sole lender. Regular and accurate MIS was shared with the bank about the company's business performance and fund forecast

The impact and value addition

We linked our fee to the revenue earned by the client, thereby providing relief to the borrower in fewer active months. With close monitoring and timely escalations, we ensured that business needs were prioritised and the bank was more confident about the propriety of payments made.

Grant Thornton Bharat sector case studies (2/2)

Client Profile: A banking company incorporated in South Africa, offering banking services in India through its Indian branch, engaged in Corporate and Investment banking, and allied banking products.

Situation and problem statement

- The client needed end-to-end tax, regulatory compliance and advisory services.
- They also asked for advice to set up a suitable entity structure in India and in IFSC GIFT City to undertake the proposed activities.

Our solution

Considering the typical issues being faced by the industry and the best practices followed, we are providing end-to-end tax and regulatory compliances and advisory services since more than 7 years.

We evaluated various options available for setting up suitable entities in India, which involved:

- Evaluating different entity options, which could be considered for set-up not only within India, but also within IFSC GIFT City
- Analyzing the tax and regulatory framework and highlighting the implications for different types of entities and activities within India and IFSC GIFT City.

The impact and value addition

Our support enabled the client in smooth implementation and compliance with various local regulations covering tax laws, labour laws, corporate laws, etc. Furthermore, GT's advice provided the bank with clarity on operational, regulatory and tax implications, which could impact their business goals, and therefore, helped them in selecting the desired entity option in India.

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Current global trends

Artificial Intelligence (AI) continues to be a major driver of innovation globally. Several organisations are evaluating its application with different elements of their ecosystem, to drive productivity gains. While its too early to talk about the success of the same, adoption of AI is a trend that has caught on significantly.

With climate change being the key challenge facing the world today, climate risk assessments are being driven by some of the largest financial institutions globally to assess the impact that climate risk will have on their portfolio.

Globally Central bankers are struggling with high inflation and the fight against it is real. Interest rates are expected to be elevated for most part of the current calendar year, with the same expected to taper off from January 2024.

De-risking from China, rather than decoupling, has been a big shift in the Sino-American geopolitical relationship. This has significantly assuaged concerns of organisations with a exposure to China. Many are exploring evaluation of local structures for China, instead of a global corporate structure. However, moving exposures away from China to countries such as India, Vietnam and other Asian economies continues to be an area of focus.

Western sanctions, which have been the biggest economic deterrent for any country, not playing by the rules of the world order are losing strength due to the alternative payment and settlement systems coming into play. We are likely to experience several innovation towards global payment and settlement systems as an alternative to SWIFT and global card payment systems such as Visa and Mastercard.

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Shaping a Vibrant Bharat

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