

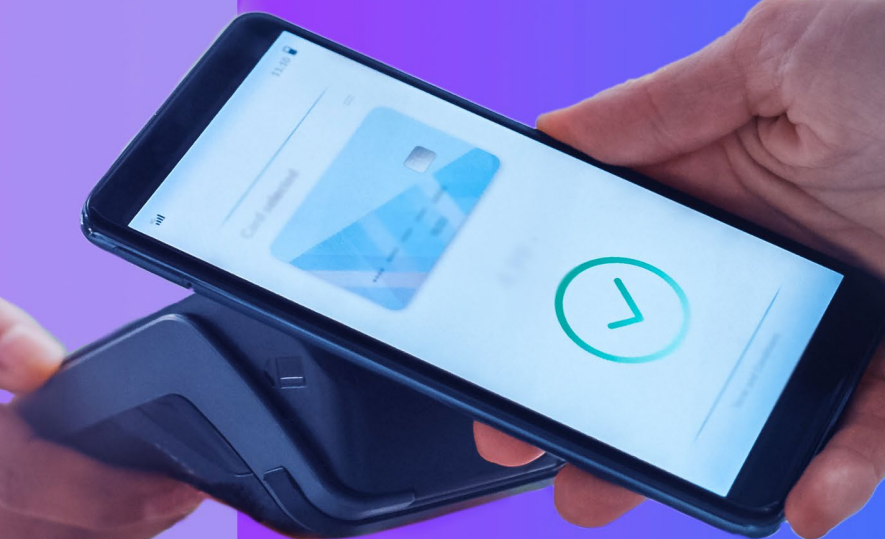


# The big slow

**M&A trends in  
financial services**

**Q2'22**

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## Introduction

# Headwinds blow against FS M&A

Dealmaking in financial services (FS) fell in the second quarter. Comparisons to the first quarter—which also was weak—were negative both in aggregate and across the three subsectors of capital markets, banking, and insurance. Aggregate FS deal volume fell 30.9 percent to 1,442 from 2,087 in the first quarter, and deal value dropped 14.8 percent, to \$163 billion from \$191 billion.

Numbers for the year's first half were somewhat better versus the same period in 2021. While first-half volume declined 8.2 percent (i.e., to 3,529 deals from 3,842), value improved 2.6 percent (to \$354.4 billion from \$345.6 billion). A big jump in the value of capital markets transactions by private equity firms accounted for the positive change.

**Strong headwinds.** Steep increases in interest rates and inflation primarily drove the decline in activity. The Federal Reserve hiked U.S. rates in May and June by a total of 125 basis points, and annualized headline U.S. inflation reached 9.1 percent in June—the highest such monthly rate since December 1981. Growth projections for GDP and corporate earnings fell accordingly, forecasts of recession increased and plunging stock prices reduced the attractiveness of equity as a deal currency.

**Bigger deals.** Among the quarter's five largest deals, four were in double-digit billions, compared to two in the first quarter. The total value of the top five deals rose 46 percent to \$70.5 billion.

**A mixed picture ahead.** Our view on the prospects for FS M&A over the next six to 12 months is mixed. On one hand, the fundamental trends that have been driving activity remain in place. On the other,

market sentiment is largely pessimistic and the outlook for interest rates and inflation is challenging.

Sixty-one percent of FS respondents to our midyear KPMG M&A Market Survey say that appetite for dealmaking in the sector either has dropped or stayed the same (see chart below). Just 25 percent—less than half—expressed the same view six months ago.

Our Office of the Chief Economist (OCE) forecasts not only that the Fed will raise rates by another 75 basis points in July,

but also that it will tighten at all seven of its remaining Open Market Committee meetings this year. The cost of debt for deals will rise correspondingly.

OCE additionally believes that inflation should peak late this year or early next year and that the risk of recession in 2023 has gone up.



**Timothy Johnson**

*Partner, Deal Advisory & Strategy  
FS Leader*

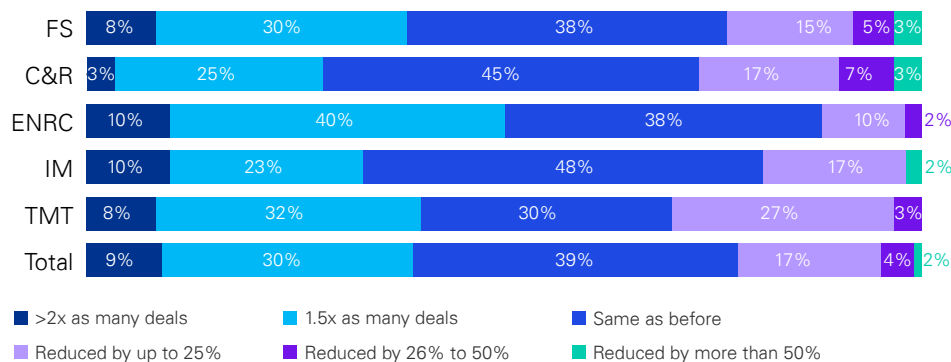
## Key statistics

**-30.9%** Decline  
in total FS deal volume  
from Q1'22 to Q2'22  
(2,087 to 1,442)

**-14.8%** Decline  
in total FS deal value from  
Q1'22 to Q2'22 (\$191  
billion to \$163 billion)

**+11.1%** Increase  
in private equity deal  
value from Q1'22 to  
Q2'22 (\$34 billion to  
\$37.4 billion)

## Within your industry, how strong is the appetite for M&A in Q2'22 as compared to 2021?



C&R: Consumer and retail  
IM: Industrial manufacturing

ENRC: Energy, natural resources, and chemicals  
TMT: Technology, media, and telecom

Source: KPMG M&A Market Survey

## Changed environment



# Optimism for dealmaking is down

Corporate enthusiasm for M&A has declined in the six months between December 2021 through June 2022. As measured by the KPMG M&A Market Survey, senior executives in financial services and five other industries—consumer and retail; energy and natural resources; healthcare and life sciences; industrial manufacturing; and technology, media and telecom—are markedly less positive about dealmaking prospects.

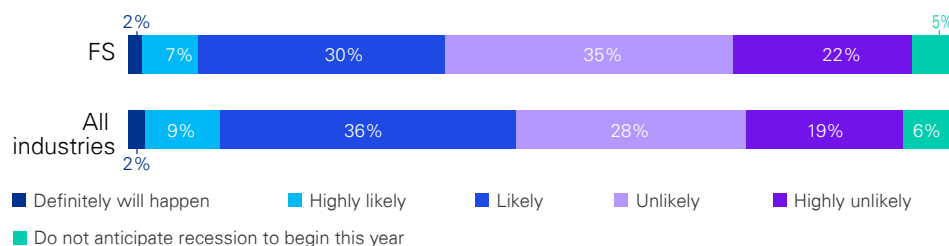
Thirty-nine percent of survey respondents, for example, currently have a strong appetite for M&A, down from 68 percent. The proportion of respondents who expected to increase their M&A activity in the next 12 months dropped to 51 percent from 65 percent. And those who believed valuations would rise in the next 12 months plummeted by nearly half, to 49 percent from 82 percent.

## Financial executives share most consensus views

Sentiment among financial services executives is broadly in line with the consensus. 38 percent of financial respondents had a strong appetite for M&A and 53 percent expected to boost their M&A activity in the next 12 months, down from 75 percent and 70 percent in December, respectively. The proportion of those believing that valuations would rise dropped to 52 percent from 80 percent.

Financial respondents also share the consensus belief on whether the downturn in the equity market this year has helped or hurt their companies.

## How do you rate the odds of a recession beginning at the end of 2022?



Source: KPMG M&A Market Survey

## What is the most significant M&A value driver for your company?

Value drivers	FS	All industries
Revenue synergies	18%	17%
Operational and cost transformation	18%	15%
Product and technology optimization	15%	14%
Speedy achievement of strategic objectives	13%	15%
Consolidation and cost synergies	13%	14%
Talent retention/ acquisition	10%	12%
Timely closing—Little or no disruption to current operations	7%	8%
Establishment of ESG monitoring and reporting	6%	6%

Source: KPMG M&A Market Survey

Thirty percent said that the market's decline had expanded the number of affordable acquisition targets and 35 percent said that it had limited their aggressiveness by reducing their own valuation. The financial perspective on another macro factor—the chances of a recession in 2022—is much more optimistic: 39 percent thought a recession was likely and 62 percent didn't<sup>1</sup> compared to the respective aggregate views of 47 percent and 53 percent.

Both financial executives and respondents as a whole cite similar M&A value drivers and barriers to value creation. The top value drivers were revenue synergies, speedy achievement of strategic objectives, operational and cost transformation, and consolidation/cost synergies (see table above), and the biggest barriers were market/competitive changes, too-high purchase prices, poor deal integration/execution, and issues related to revenue synergies.

<sup>1</sup> Percentages do not add up to 100 due to rounding.

## By the numbers

# Volume and value down

Transactions involving U.S.-based FS companies declined in the second quarter compared to Q1'22 across the three major subsectors we follow:

- Capital markets dominated Q2 total FS deal volume (1,165 deals, or 80.7 percent) and value (\$156.8 billion, or 96.2 percent).
- There were 65 banking deals (4.5 percent) worth \$2.3 billion (1.4 percent).
- Insurance accounted for 212 deals (14.7 percent) valued at \$3.9 billion (2.4 percent).

**Strategic versus private equity.** Q2's 1,250 strategic deals worth \$125.7 billion declined 32.4 percent and 20.3 percent from their respective Q1 levels. While Q2 private equity volume dropped 19.7 percent to 192 deals, PE value surged 11.1 percent to \$37.4 billion on deals in capital markets and banking.

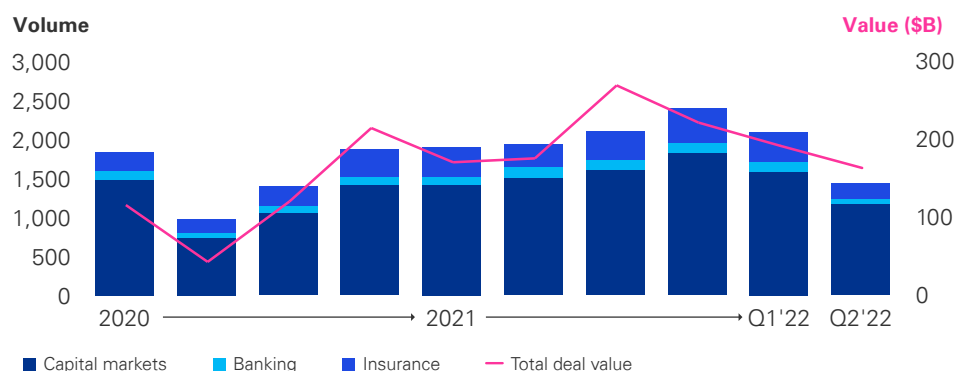
As in Q1, the top five Q2 deals included three strategic and two by PE buyers. The two biggest were strategic acquisitions by real estate investment trust (REIT) Prologis (\$26 billion) and financial exchange parent Intercontinental Exchange (\$13 billion). Blackstone's \$13 billion purchase of REIT American Campus Communities was the biggest PE deal.

**Cross-border deals.** Domestic deals accounted for 79.8 percent of FS volume, while 10.6 percent was inbound (i.e., overseas companies buying U.S. targets) and the remaining 9.6 percent was outbound (U.S.-based companies buying overseas targets).

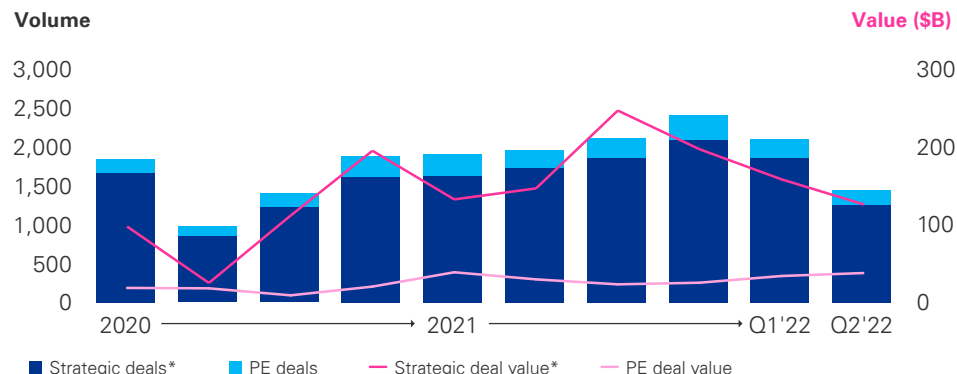
## Top FS deals Q2'22

Acquirer	Target	Value (billions)
Prologis	Duke Realty Corporation	\$26.0
Intercontinental Exchange	Black Knight	\$13.1
Blackstone; Blackstone REIT	American Campus Communities	\$12.8
IFM Investors; DigitalBridge Group,	Switch	\$11.0

## U.S. FS activity by sector



## Strategic and PE FS deals



\* Includes SPAC deals (\$3.7 billion SPAC value and 5 SPAC volume for Q2'22)

About the data: Data was sourced from CapitalIQ, Refinitiv, Pitchbook, and KPMG analysis. The values and volumes data cited are for U.S. deals announced during each quarter. Previously published statistics may be restated to incorporate new data and/or changes in deal outcomes.

## By the numbers



### Capital Markets M&A trends

## Keep the faith

While capital markets M&A fell in the second quarter versus Q1'22, the subsector held up much better than banking and insurance. Deal volume declined 26.4 percent, and deal value minimally rose .09 percent, versus Q1.

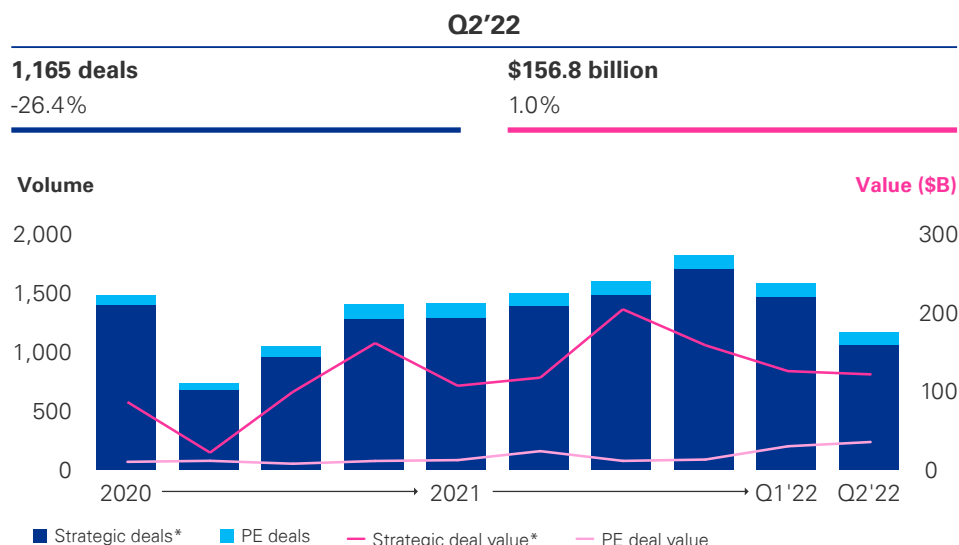
Capital markets dominated overall activity in financial services as well. Not only did it represent 80.7 percent of FS volume and 96.2 percent of FS value, but it also included all of Q2's 10 largest FS deals.

**Real estate.** Three of the quarter's top 10 transactions were in real estate, all of which had real estate investment trusts (REITs) as targets. Logistics REIT Prologis announced its acquisition of industrial REIT Duke Realty for \$26 billion, and affiliates of Blackstone, a giant real estate investor, announced the purchase of REITs American Campus Communities (\$13 billion) and PS Business Parks (\$8 billion).

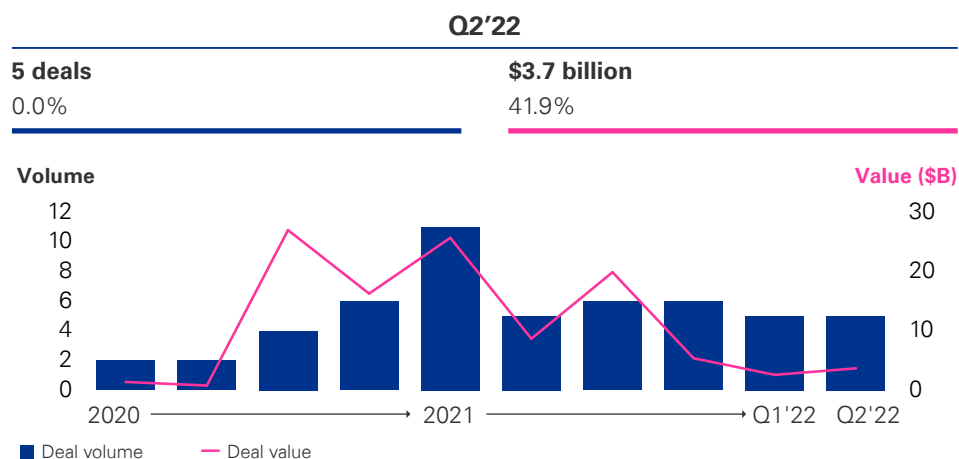
We expect M&A to remain robust in commercial real estate. While institutional investors face a predicament as interest rates rise—i.e., that their cost of capital has become higher than many properties' yields—they may find value in commercial subcategories with characteristics that are desirable in the current environment.

These subcategories notably include hotels, which can adjust pricing to hedge against inflation; industrial, where vacancy rates are low in many markets; and medical offices, where tenants tend to be financially sound and lease schedules have escalating payments.

## Capital markets deal volume and value



## FS SPAC deal value and volume






Our view is less sanguine for the residential market. Even as the median selling price of existing U.S. homes reached an all-time high of \$407,600 in May,<sup>2</sup> sales fell for the fourth consecutive month and have subsided to prepandemic levels. What's more, rising interest rates have reduced mortgage applications to their lowest level since 2000.<sup>3</sup>

**Asset management.** Deal activity targeting asset managers was subdued in Q2. Even with the current downturn in financial markets, though, the factors driving long-term consolidation in the industry are very much intact.

Chief among these are relentless downward pressure on fees, which increases the urgency to boost assets under management; the need to contain rising expenses; the growing popularity of multi-asset vehicles and alternative investments such as private equity and private credit; and customer demand for products emphasizing environmental, social, and governance principles.

M&A can provide a solution for all of these. We believe that savvy acquirers will use the weakened condition of the economy and markets as an opportunity to make deals that will differentiate themselves—and strengthen their competitiveness going forward.

## Top capital markets deals in Q2'22

 Acquirer	 Target	 Value (billions)
Prologis	Duke Realty Corporation	\$26.0
Intercontinental Exchange	Black Knight	\$13.1
Blackstone; Blackstone REIT	American Campus Communities	\$12.8
IFM Investors; DigitalBridge Group	Switch	\$11.0



<sup>2</sup> "Existing Home Sales Fell 3.4% in May etc.," National Association of Realtors, June 22, 2022.

<sup>3</sup> "Mortgage Applications Drop 6.5% etc.," gobankingrates.com, June 10, 2022.

## By the numbers



### Banking M&A trends

## Activity slows, pressure doesn't

Banking M&A slowed in the second quarter. Compared to Q1'22, deal volume and value fell 47.2 percent and 87.4 percent, respectively. We see several trends that should encourage activity in the next six to 12 months.

**Higher interest rates and inflation.** If, as our economics team forecasts, interest rates and inflation continue to rise at least through year-end, their impact on banking M&A should be mixed. Larger banks should profit at the expense of smaller players.

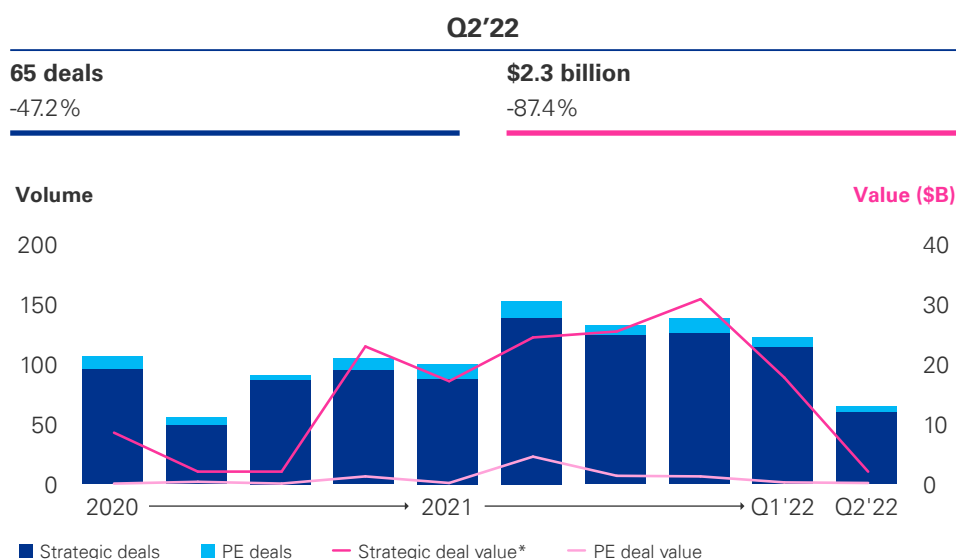
Rising rates mean that banks can charge borrowers more, even as they pay their depositors more as well. Earnings for the biggest global, national, and regional banks should especially benefit because their borrower base is much larger and more diversified. Smaller banks, by contrast, typically raise borrowing rates more slowly to avoid potentially losing customers.

The M&A implication is that smaller banks may struggle to remain competitive—and thus become vulnerable targets for bigger banks, which will be looking for opportunistic acquisitions.

**Fewer options for fintechs.** Fintechs will find it much harder to borrow as rates rise and much harder to raise equity capital as economic growth slows. They also will have to shift their focus to generating profits instead of raising revenues, which can be tough for younger companies trying to establish themselves.

As with smaller banks, this should leave many fintechs more exposed to acquisition or compel them to sell equity stakes for badly needed capital. (Read more about this on page 10.)

## Banking deal value and volume



## Top banking deals Q2'22

Acquirer	Target	Value (billions)
CCF Holdings	Direct Lending Business of Curo Intermediate Holdings	\$0.3
Brookline Bancorp	PCSB Financial	\$0.3
United Community Banks	Progress Financial	\$0.3

**Ongoing consolidation of community and regional banks.** Consolidation among smaller regional and community banks continued in the second quarter. Two of the quarter's biggest strategic deals involved regionals buying competitors to expand their geographic reach and beef up their depositor bases.

Brookline Bancorp announced its acquisition of PCSB Financial for \$313 million. The deal adds PCSB's operations in eastern New York to Brookline's branch network in Massachusetts and Rhode Island. United Community Banks, a player in several southeastern states, announced its \$272 million purchase of Progress Financial, which operates in Alabama and Florida.

We expect further consolidation of regional and community banks. The higher-interest-rate dynamic that we described above should additionally incentivize activity.

## By the numbers



### Insurance M&A trends

## Reasons for optimism

The pace of insurance M&A decelerated in Q2 for the second consecutive quarter. Deal volume and value declined 44.5 percent and 77.9 percent, respectively, from their first-quarter levels.

While the worsening economic environment compels us to be cautious on dealmaking in the near term, we note that higher interest rates should be beneficial to many insurance carriers. Because carriers' massive bond portfolios should generate rising interest flows, their cash balances will improve—and their ability to pay claims will improve accordingly.

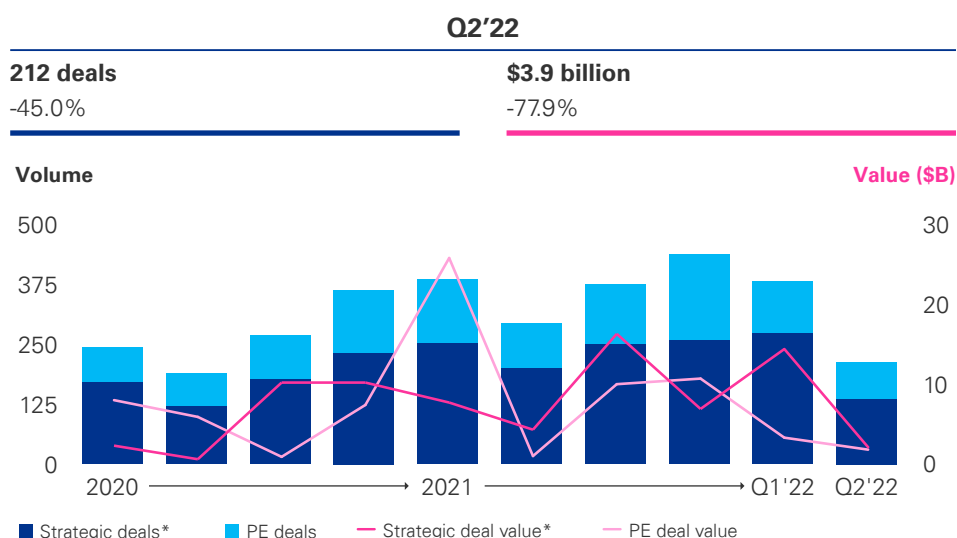
We remain optimistic about the longer-term prospects for deal activity in certain subcategories, particularly brokerage and insurtech.

**Brokerage.** Recent weakness aside, demand for distribution businesses has been high for some time. Brokerages want to bulk up to be more competitive and private equity players seek to build their own large-scale distribution capabilities via acquisitions. Indeed, the biggest insurance deal announced in Q2 was British generalist broker Howden's purchase of U.S. reinsurance broker TigerRisk Partners for \$1.6 billion.

The primary drivers for brokerage consolidation are still in place: sticky rate increases, which make revenues stronger and more predictable; the potential for economies of scale via aggregation; the need for digital transformation; and the recognition that brokers face inevitable consolidation as insurance carriers themselves combine.

**Insurtech.** Insurtech companies had a record-breaking year in 2021 as measured by the number of deals (566) and the

## Insurance deal volume and value



## Top insurance deals in Q2'22

Acquirer	Target	Value (billions)
Howden Group Holdings	TigerRisk Partners	\$1.6
JAB Holding Company	Crum & Forster Pet Insurance Group	\$1.4
Abu Dhabi Investment Authority; Guggenheim Investments; Oak Hill Advisors	Acrisure	\$0.7
SH Residential Holdings	NTitle/Entitled Insurance Agency/CLM Mortgage/Chesmar Homes	\$0.5

amount of funding they received (\$15 billion).<sup>4</sup> But as with financial services more broadly, activity has slowed thus far in 2022. Moreover, most insurtechs that went public in the past 12–18 months are trading far below their initial valuations.

We see this as a bad news/good news scenario for insurtech M&A. The bad news is that investors' cooling enthusiasm has pulled valuations down—which also is the good news.

Given today's challenging economic conditions, we expect some insurtechs to merge with competitors, and that other insurance acquirers will pursue deals more selectively and strategically. While acquirers will continue to target insurtechs that offer the most attractive technologies and talented professionals, we believe they also will focus more sharply on the realities of an insurtech's business model and path to profitability.

<sup>4</sup> State of Fintech 2021: Insurtech, CB Insights, March 17, 2022.

# Balancing pros and cons

Our outlook for financial services M&A in the second half of 2022 and early 2023 is a mix of caution and optimism. As we've discussed in the preceding pages, there are solid reasons why activity should remain subdued—and plenty of others that bode well for dealmaking. Companies thinking about merging or acquiring will have to weigh the pros and cons and strike the right balance to succeed.

The macroeconomic picture isn't promising. Annualized headline inflation in May reached its highest level since December 1981, and our Office of the Chief Economist (OCE) expects it to rise even higher and potentially peak by year-end. Along with OCE's forecast that the Federal Reserve will raise interest rates another seven times this year, this inflation view suggests that the economy

may go into recession by the first or second quarter of next year.

OCE additionally points to another, under-the-radar potential source of tightening: the Fed's decision to shrink its balance sheet after two years of pandemic-induced expansion. By allowing its massive holdings of Treasury bonds and mortgage-backed securities to mature without replacing them, the Fed effectively will drain the financial system of trillions of dollars.

FS executives see factors both for and against making deals. 38 percent of FS respondents to the midyear KPMG M&A Market Survey have a strong appetite for M&A. These optimists cited three factors as the strongest drivers of more activity: the urgency of digital transformation, the need for other technological

advancements, and a rising level of competition forcing companies to become more competitive.

The 23 percent of FS respondents who report a weaker M&A appetite (note: 38 percent say their appetite is unchanged) cited other strong factors as the biggest obstacles to more activity. The top three such obstacles were uncertainty about the economy, geopolitics, and potential tax changes; inflation and rising interest rates; and the high cost of capital.

These and other survey results indicate that financial companies want to do deals but are mindful of the significant hazards in today's environment. In other words, they must strike a balance of pros and cons to decide whether to proceed.

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## What KPMG FS specialists are saying



### On the outlook for M&A involving alternative investments

Alternative categories such as hedge funds, private equity, private credit and real estate are in demand not only by managers of traditional assets, insurance companies and institutional investors, but also, increasingly, by high-net-worth and retail investors. The popularity of

alternatives is such that this demand should persist going forward. Private credit is especially desirable as interest rates and inflation go up because it gives fixed income managers much more diversification and flexibility in structuring their portfolios.



## KPMG on the impact of rising rates and inflation on fintech deals

Will rising inflation and interest rates slow the pace of M&A involving fintechs and banks? The answer is really yes and no. It starts with fintechs' diminished ability to raise capital when inflation and rates are going up. Traditional funding sources such as venture capital and private equity will be reluctant to invest in younger, less established fintechs because the fintechs' business prospects become less solid in challenging economic conditions. And the weak equity market has made the IPO option a no-go in most cases. All of these reasons point to fewer deals in the near term.

The bright side for now is that well-positioned banks and fintechs should have the opportunity to fund or acquire assets that might otherwise be available at a much higher price or not at all. Looking ahead, the long-term drivers of fintech M&A are still in place. Banks need fintechs for digital transformation, innovative technologies, new-product development, and high-quality talent, and fintechs need banks for funding, commercialization, and long-term viability.



## Ram Menon on where to look for insurance activity

Insurance activity should be strongest in brokerage—where consolidation and demand from private equity have remained robust—and the life/retirement segment. Life/retirement should be busy as the large carriers continue to assess their portfolios. We expect them to carve out noncore businesses and make strategic acquisitions in priority areas. AIG, for example, has carved out its life/retirement unit, renamed it as Corebridge Financial and filed for its IPO at some point in 2022.

We're less optimistic about property and casualty, where the combination

of hardening pricing with rising rates and inflation typically steers carriers toward organic growth and away from acquisitions. The major players are unlikely to take on additional balance-sheet and integration risks in the current environment. But there's always the possibility that vigilant strategic acquirers will strike if the right deal materializes. If an opportunity comes up for a strategic acquisition that will help the buyer add scale, market share, or specialty risk diversification, potential acquirers will line up and compete to win the deal.



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**With special thanks to:**

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With a FS specialization, our teams bring both transactional and operational experience, delivering rapid results and value creation.

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