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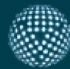
Financial Services Market Insights

Reflecting on the year to date and looking ahead to 2023



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Alex is CIL's Senior Partner, focusing on the firm's approach to clients and markets. He also leads the Financial Services and Business Services practices. He has over 20 years' experience in consulting.

Alex has advised clients in a wide range of financial services industries, including lending, insurance, wealth management and payments. Within business services, Alex's experience spans professional services, human capital, BPO, property services, logistics and document management.

The bounce out of COVID was strong for many businesses across insurance, lending and wealth management. Wealth managers have, until recently, benefited from the public markets rally, as well as rapid turnover growth among the insured, driving up insurance premiums (along with hardening markets), to the benefit of brokers. Lending volumes surged as the housing market and economic growth recovered during 2021 and the first half of 2022. However, assessing what the market's given them over this strong run versus their own organic growth capability, is a key challenge for investors into the sector.

Financial Services deal flow has continued strongly since, with particular interest in wealth management, insurance, technology and trust and fund administration deals. However, rising inflation and macroeconomic uncertainty is leading investors to pursue new strategies and innovate accordingly.

At CIL, we have seen a trend towards US investors looking to the UK to capitalise on currency arbitrage making businesses comparatively cheaper. UK and US investors are also turning their focus to Europe, where there's a less pressured valuation situation, particularly in wealth management and insurance.

There is also a keen focus within the General Partner community to think through value creation. To justify the strong entry multiples PE have been seeing, there is, in most cases, a strong requirement to achieve some form of transformation during the hold period. We have seen people planning very ambitious buy & build programmes to ensure that there is a scale premium at exit.

Wealth Management

The next six to nine months will be an interesting time for the wealth management market and management teams need to ready themselves for the upturn. 'Normal' inflationary environments have historically been quite good for wealth management businesses, largely because markets rose with inflation in the past. However, the

dislocation we're currently seeing where inflation is not reflected in asset prices is more challenging.

Our observation is that when markets fall, your customers stick with you. It is when you miss the recovery that you lose them. We wouldn't expect many wealth management businesses to see above average churn just yet, because we are yet to see the results of their investment committees' capital preservation strategies.

Home-buying value chain

Another dimension of financial services uncertainty lies in mortgages. We are currently analysing which buyers are currently locked out of the market because of pricing challenges and rising LTV requirements, and which segments are struggling to remortgage.

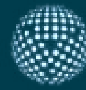
When we look at the pool of potential homebuyers, we are seeing one group unable to secure a mortgage because they don't have a large enough deposit, and another group who are unable to purchase the property they want because vendor expectations are not dropping fast enough; when leverage tightens, values must correct.

The value chain that sits behind the home-buying market; home insurance, estate agency, mortgage distribution etc, is experiencing a dry spell as a result.

We don't anticipate significant repossessions, though; lenders have learned the negative political and brand ramifications. In addition, the commercial outcomes have been poor, so they are highly motivated to keep homeowners in their properties. I expect a slowing of the market in the short term but anticipate we will be back to pre-pandemic levels within 12 months.

From a PE standpoint, some investors will see the current climate as an opportunity. Our research of PE investors across the UK confirms that the PE market has switched from being a seller's to a buyer's market. But, there are always businesses who need to address challenges by raising capital and there are investors who can provide solutions. Value focused investors will be optimistic about where they can generate returns for their investors and LPs.

Across financial services there is an hourglass problem – there are plenty of small entrepreneurial businesses emerging and growing quickly, and there is a wealth of large banks, lenders and insurers, but not a great deal in the middle. We expect lower-mid-market deal flow to hold up better in the near term. There is arguably a surplus of mid-market investors wanting to deploy north of £100m of equity relative to the pool of investable assets and of affordable leverage.



Christian Kent

Managing Director at Houlihan Lokey

Christian is a Managing Director in Houlihan Lokey's Financial Services and Technology team. He is based in the firm's London office. Throughout his career, Christian has advised on a wide range of completed transactions, including sales, acquisitions, capital raisings, IPOs, debt financings, and restructurings. Christian is primarily focused on businesses in wealth management & pensions, specialist asset management, fund administration & services and banking & lending.

It has been a very buoyant and active year in the wealth management sector, with private equity investment coming into the UK from both Europe and the US. We have also seen strategic investments from the likes of Aviva and Royal Bank of Canada.

Notwithstanding uncertainties in the UK economy, the fundamentals of the wealth management market remains very strong with a growing addressable market. Structural shift from defined benefit to defined contribution has led to individuals having more choice over their own asset allocations and the greater need for an advisor. There has also been a general growth of affluence in the UK, and with aging populations, people are living longer and needing advice in retirement.

In the wealth management sector we have a very fragmented space, and where you get fragmentation, you often find private equity investment, as funds seek the opportunity to institutionalize the sector from a cottage industry into something much more professional.

There are currently 27,000 advisers across over 5,000 firms in the UK and consolidation platforms have been working to bring these together. Smaller firms are generally burdened with compliance, increasing FCA oversight and cost, and for some it can often be challenging to get PI insurance. We have also seen an aging of the advisor base, with advisors looking to retire and sell their businesses. As a result, and with the addition of capital coming in, we have seen consolidation by the platforms who are buying smaller businesses, merging and professionalising them, and ultimately introducing significantly better product and technology to improve the client experience and outcomes. The same theme has existed in the US, and US PE firms are seeking to replicate this in the UK.

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Impact of the financial climate on wealth management businesses

Wealth management businesses tend to be resilient during periods of volatility. Revenues have traditionally not been directly correlated to equity markets, albeit fixed income has also performed poorly this year. In addition, during a period of volatility, clients will turn to their advisors looking for advice and do not necessarily want to keep their money in cash. As a result, we have seen a number of platforms achieving positive net flows this year as clients deploy more money. History would also suggest that you do not want to miss the best days when markets rebound – over the last 20 years annualised total returns from the UK Equity Index were 5.6%, reduced to negative 0.4% if you missed the best 20 days and 2.0% if you missed the best 10 days.

Outlook for the next 12 months

The cost of debt has risen and IFA consolidation platforms are often debt funded. We will have to see what impact this has on their ability to continue acquiring firms. We expect there to be more impact on some of the smaller firms.

There is no doubt that the opportunity to keep acquiring smaller firms is there and this could play out well for the larger, well-funded platforms. With recurring revenues lower, as a result of a reduction in assets under management or assets under advice, the acquisitions will become cheaper even if you pay the same multiple.
We anticipate increasing focus on differentiation, such as on businesses focusing on providing clients with sustainable portfolios and good use of technology in winning clients and in the middle and back office.

Finally, we expect to see continued M&A activity at the larger end. For the best businesses we do not anticipate a material softening of the multiples paid, however we do anticipate a forensic approach to due diligence in ensuring that the EBITDA is reflective of current market conditions. The weakness in the pound also makes deals look cheaper for US acquiring firms. In the coming year we may also see the larger well-funded consolidators turning their mind to consolidation of the consolidators, ultimately resulting in a smaller number of PE backed platforms. We have seen this trend in the insurance distribution sector.

Jeremy Sweetnam

Partner, Technology and Financial Services at PWC

Jeremy is a Fintech M&A advisor with over 15 years' corporate finance experience focused on digital banking; P2P & alternative finance; point-of-sale, online & mobile payments; foreign exchange & money transfer; wealth/insurtech; financial services SaaS platforms; and capital markets software.

As part of the largest global network of M&A advisors with PwC Corporate Finance, Jeremy provides advice and financial services market knowledge to private shareholders, corporates and institutional investors seeking to buy or sell businesses or raise capital.

On my return from Money20/20 this summer I reflected on the mood at Europe's largest fintech conference. The collapse in technology and fintech valuations on the public markets weighed heavily so whilst the public presentations were upbeat, it was far more bearish in private conversations.

The reason for this was obvious; the decade-long fintech investment boom, which had survived Brexit, Covid and several other headwinds, was now over. In retrospect, autumn 2021 was the top of the market. Since then, a combination of factors has resulted in fintech valuations falling across all geographies and subsectors in H1 2022, with a small number of high-profile deals propping up the numbers. What started in the public markets eventually found its way to the start-up world as the flow of VC capital slowed up significantly.

Despite this, mid-market M&A activity, always a laggard, has held up quite well as private equity, with an unprecedented level of dry powder, has continued to invest. Payments, particularly B2B, online, digital money transfer and payment processing, have continued to attract investment. Other pockets of resilience have included cybersecurity, and data & analytics.

As the market adjusts, the investment focus will shift from disruptiveness to more pragmatic strategies, which see fintechs work collaboratively with larger incumbents rather than trying to displace them. Integrated payments and embedded finance are two such examples of monetising established technologies.

Furthermore, there is a pivot from revenue growth to sustainable profitability. Previously it was all about super growth, buying into the management teams who

had done it before, market share grab and burn rates. VCs are still investing but they are more cautious and want to see more track record, a clear path to profitability and longer-term funding runway. They are doing more diligence, demanding higher percentage ownership, and are more carefully structuring their investments. Across the board, there's still an appetite for businesses that can defend against cost inflation or have business models built on cross-sell (which will deliver better return than having to invest in acquiring new customers).

At the same time, VCs have been bifurcating their winners and losers, advising their weaker portfolio companies to cut costs and consider strategic exits to avoid the worst-case scenario. This is what strategics have been waiting for. They have unprecedented cash on their balance sheets, but up until now they could not match public companies or enthusiastic PE on price. Now they will drive consolidation as valuations continue to come off, the IPO market remains closed and tightening debt markets mean less aggressive behaviour from PE. Those strategics may yet be joined by other fintechs, such as Revolut, who have raised significant investment capital recently.

In summary, much will depend on when the IPO market opens for business again, as without it, M&A remains the only way for founders and VCs to access liquidity. The gap in valuation expectations is holding back M&A. For now, the top of the market is still fresh in shareholders' minds and founders still cling to 2021 valuations. This must and will change as memories fade and founders and VC come to terms with the new reality that 2021 prices are not coming back anytime soon.

Once valuation expectations begin to coalesce, M&A will provide an attractive solution not only for struggling fintechs running out of road, but also for incumbents and more mature well-funded competitors looking for incremental growth and profitability. Against that backdrop, and now more than ever, investing in value creation and preservation strategies will be vital to determining how and when to hit the M&A trail, for both buyers and sellers.

One thing is for sure, Money20/20 will be a very different conference.

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