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The Three Biggest Trends in Financial Services

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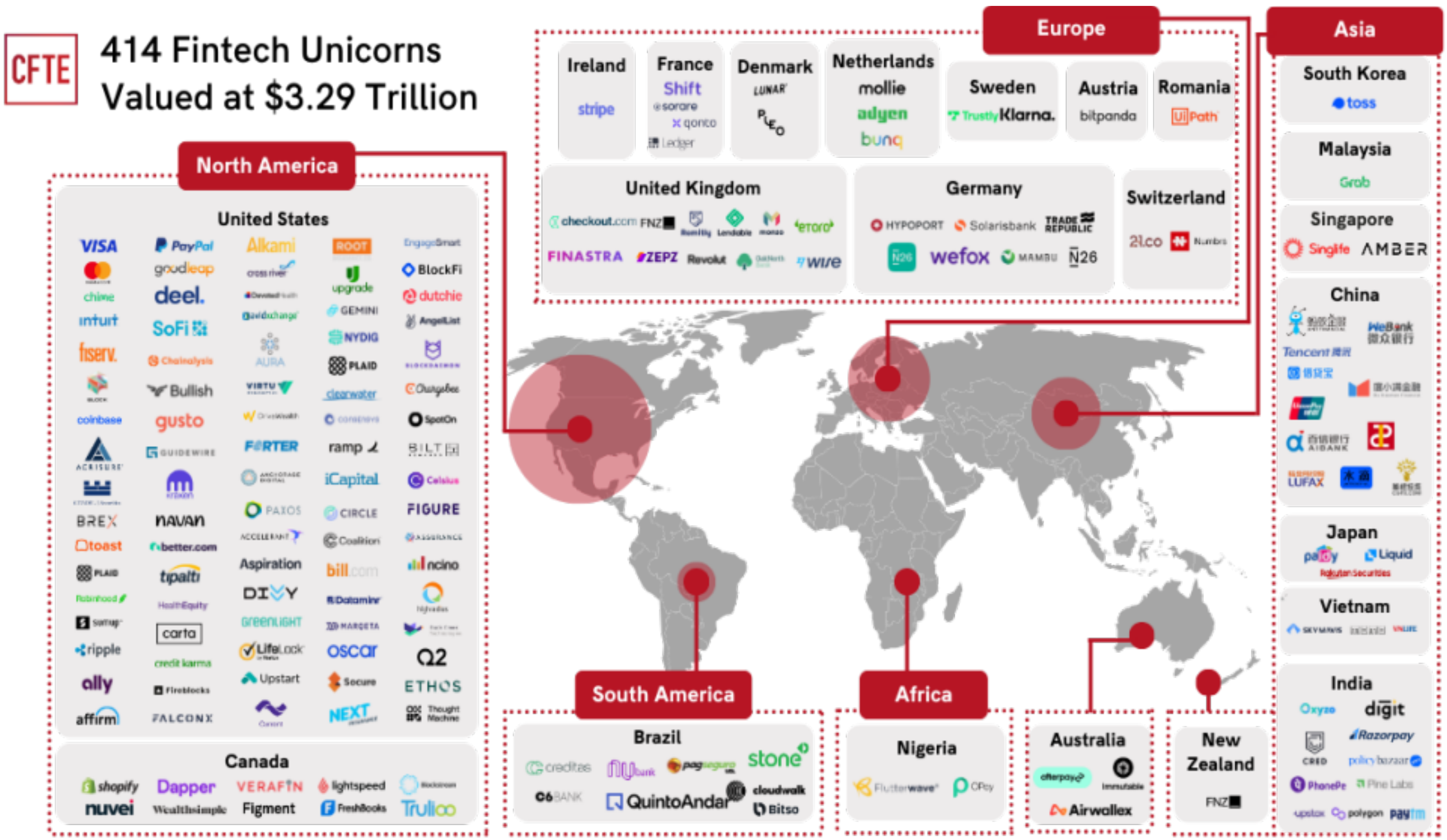
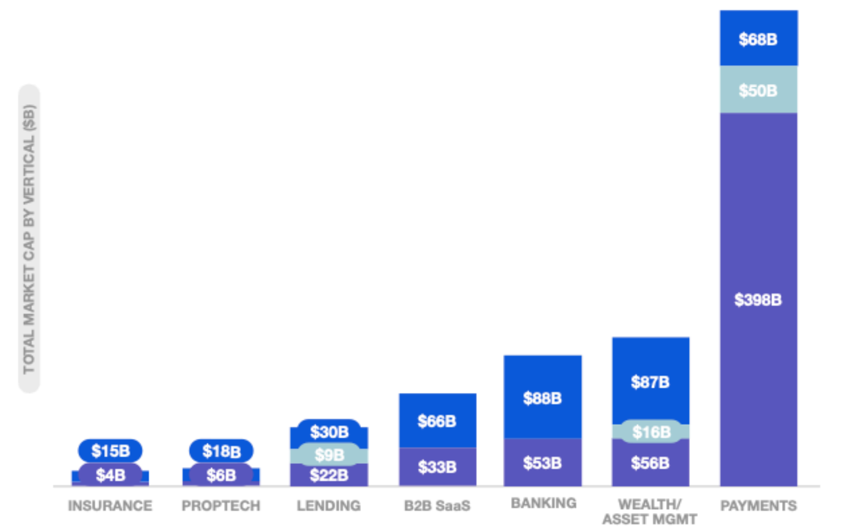
The financial services industry is currently undergoing a period of significant transformation, driven by several key trends: the rise of financial technologies (fintech), increasing M&A activity, and the normalization of interest rates. Despite this, valuations of financial services companies remain at historically low levels – 8X earnings and 95% of book value – giving investors inexpensive access to a rapidly-expanding market that stands to benefit from these overlapping trends in the coming years.



Widespread Adoption of Fintech

Fintech has been instrumental in transforming the financial services sector, particularly over the last 15 years. Today new-age technologies such as artificial intelligence (AI), quantum computing, machine learning, and blockchain are changing the way we bank at an unprecedented pace. Bank of America and JP Morgan currently spend more than $26 billion collectively on technology each year to improve cybersecurity, optimize operational efficiency, and enhance customer experience.Over the next decade AI and machine learning algorithms will become indispensable fintech tools that will enable financial institutions to analyze vast amounts of data in real-time, personalize customer experiences, detect fraud, and optimize investment strategies. The tokenization of assets will be widespread as blockchain technology offers increasingly secure, transparent and decentralized transactions. At the same time, compliance solutions leveraging regulatory technologies will streamline regulatory processes, enhance transparency and mitigate risk for financial services companies. The next decade in fintech promises to be a period of unprecedented growth, innovation and transformation. With advancements in technology, evolving consumer preferences and regulatory changes, the fintech industry is set to revolutionize financial services paving the way for a digitally-driven financial ecosystem. Fintech's market size currently exceeds $340 billion, and is expected to increase fourfold by 2032. Adopting fintech is no longer a choice but a necessity for financial services companies.

After two years without a large fintech IPO, many sizable companies are now filing or considering going public

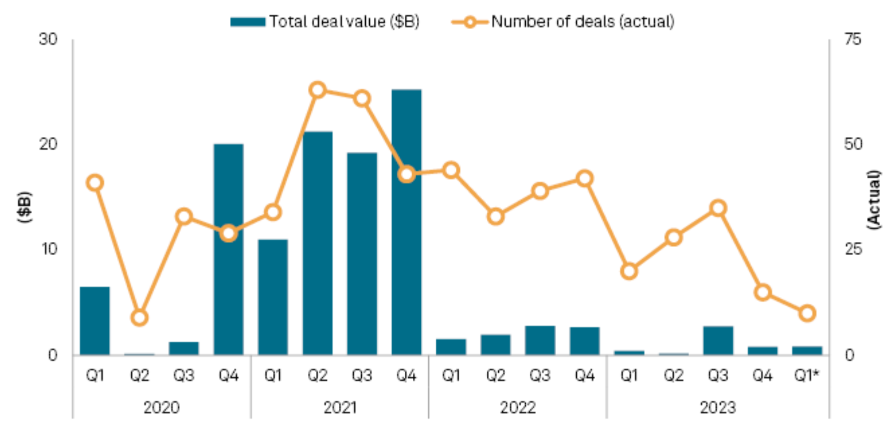


Source: PitchBook, TechCrunch, Capital IQ, F-Prime team analysis
Note: Exited companies added to index after 3 months of trading in public markets.
Valuation date: 12/31/2023

Uptick in Smaller M&A Transactions

In the current environment marked by continued uncertainty stemming from challenging macroeconomic conditions and geopolitical tensions, there has been a decline in mega deals in financial services. However, the mounting pressure on small banks to remain relevant and profitable is actually driving M&A deals on a smaller scale. The adoption of fintech is driving a lot of M&A activity among small financial services companies, who must adopt expensive new technologies to grow, remain relevant and maintain profitability. However, the adoption of fintech can be extremely complex and prohibitively expensive. And while it may be essential to their survival in the coming years, small banks actually benefit far less from the adoption of fintech when compared to larger banks because these benefits are spread over fewer transactions and therefore accrue limited financial gains. If a fintech that costs $100 a month can increase revenue by a $1 per transaction, and a small bank processes just 10 transactions a month, that bank will not make a profit. On the other hand, a major bank that processes 1000 transactions per month stands to profit from the adoption of the same fintech. Often there is no option for smaller banks but to merge or be acquired by a larger player with more resources to compete effectively in a world of rising technology costs and increasingly powerful competitors. This dynamic is increasing M&A activity among small financial services companies.

Bank M&A 2024 Deal Tracker



Data compiled Feb. 5, 2024.

Analysis limited to US-based whole company, minority stake, and franchise bank and thrift deals that were announced between Jan. 1, 2020, and Jan. 31, 2024. Excludes branch, government-assisted and terminated deals as well as bids and thrift merger conversions.

* Quarter to date through Jan. 31, 2024.

Deal values are as of the announcement date.

Source: S&P Global Market Intelligence.

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Normalization of Interest Rates

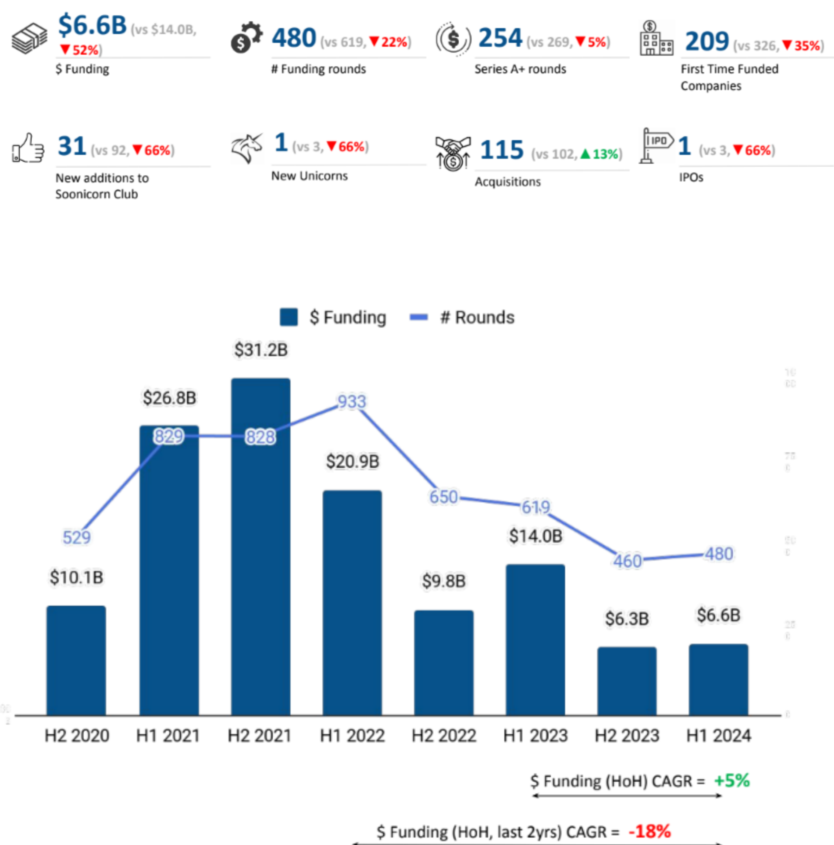
The U.S. Federal Reserve Bank has maintained a zero-interest rate policy (ZIRP) for 11 of the last 15 years, which cut off the lending business of banks and made it difficult to secure investment. In March, 2022 the Federal Reserve Bank raised interest rates for the first time in four years, and hiked its benchmark rate ten more times by July of that year. Interest rates should soon stabilize at well above zero, which will widen loan and investment spreads in the long term.

Banks must adjust their asset-liability management to counteract loans made at lower interest rates, even as the yield curve starts to normalize. After normalization, net interest margins will rise and bank profitability should increase by more than 10%, making financial services companies an attractive investment.

Capitalizing on Trends

Investing in financial services has been out of favor since the 2008 Global Financial Crisis, which has pushed bank valuations to historically low levels and created an opportunity to invest in a sector that is poised to benefit from the tailwinds of fintech, rising M&A activity and an ever-improving interest rate structure.

US FinTech Funding: H1 2024



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