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FS Valuations Market Snapshot
June 2017 issue

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The FS Valuations Market Snapshot!

Albertha Charles
Partner,
FS Valuations Leader

Welcome to our second issue of the FS Valuations Market Snapshot.

The following sections cover our regular sector focus analysis.

Banking

Since the start of the year, the European economy has started to show growth and unemployment is falling further. The banking sector is strongly correlated with the underlying economy and some of the Q1 2017 (e.g. Lloyds Banking Group) result announcements have exceeded analyst expectations. There are however, some laggard banks (mainly in Italy) that will require further restructuring and recapitalisation. We have seen multiples for UK banks rebound to where they were just before the EU referendum. There is an element of recovery following the unexpected outcome of the EU referendum and the sentiment that IFRS 9 (the new accounting standard that brings forward the recognition of loan losses) may not be as punitive as initially feared. Despite the recent rebound, we would caution that there are other regulatory changes in the pipeline that could reverse this trend.

Insurance

The UK non-life insurance sector has undergone a number of specific challenges over the last year, most notably the continued problematic underwriting environment experienced by the London Market and the unexpected cut in the Ogden discount rate. Despite these challenges, the industry remains robust and company valuations continue to be attractive. As a result of the EU Referendum vote, passporting has become a major concern across the sector. We are seeing a number of insurers developing restructuring strategies to set up new EU subsidiaries, effectively enabling them to write European business in the event that passporting rights are lost through Brexit negotiations.

Asset Management

The UK's assets under management have continued to increase despite withdrawals post the referendum, driven by inflows and positive market movements. Asset management trading multiples have reverted from their post-Brexit levels and are now within their long term range of 8x to 10x EV/EBITDA. M&A activity has also gathered significant pace in the past few months driven by multiple strategic considerations including scale, expansion into new products, solutions and markets, access to talent and technology, and regulatory changes. We expect these drivers to continue positively impacting the deal momentum in upcoming months.

We hope you find our Market Snapshot interesting and welcome your feedback and thoughts.

Also, do have a read of our published blogs on hot topics, which can be found at:

http://pwc.blogs.com/deals/

If you would like to discuss any valuation issues you are faced with, please do get in touch.

Yours sincerely,

Albertha Charles

Email: albertha.charles@pwc.com
Tel: + 44 (0)20 7804 5469

Sector: Banking

The landscape of European banking continues to ride a turbulent wave

Lower RoE is driven by a small number of less profitable European banks while UK challenger banks continue to experience steady growth

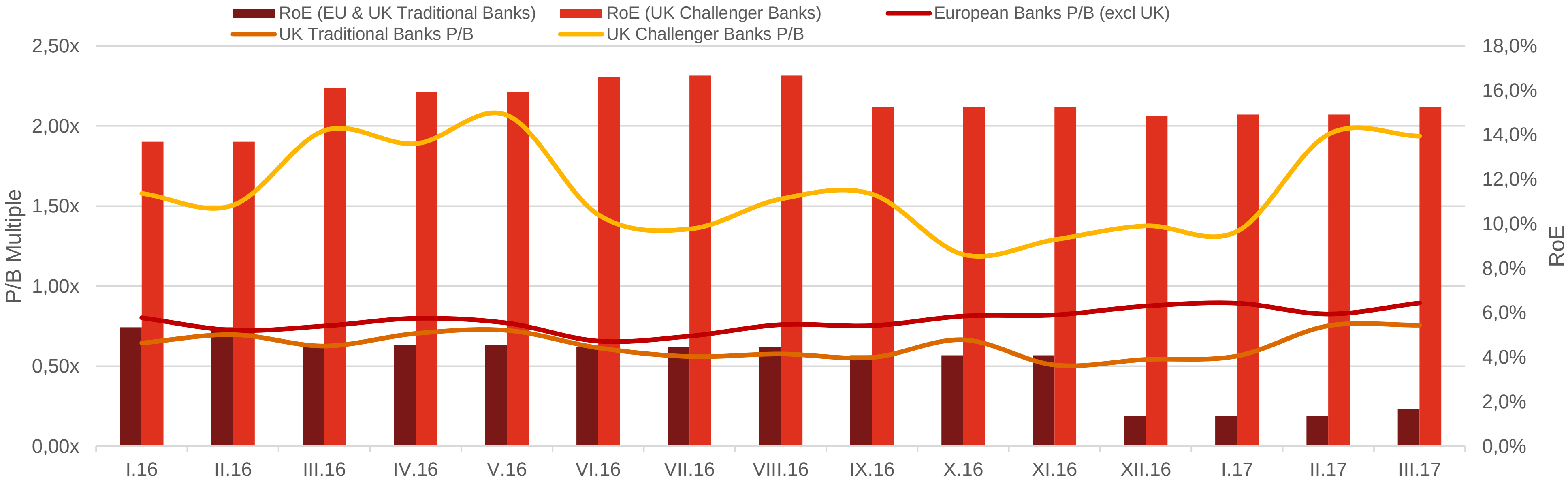
The relationship between RoE and P/B multiples is beginning to normalise as European economies start recovering

European banks' CDS spreads have been relatively stable and equity markets are on the rise, however Italian banks are still in the spotlight

Sector: Banking

UK challenger banks continue to trade at higher multiples as compared to their traditional counterparts

Figure 1: Trading multiples for UK traditional banks, UK challenger banks and their European counterparts



Source: Capital IQ, PwC analysis

- We have seen P/B multiples for UK traditional banks rebound to where they were just before the British EU membership referendum (0.9x).

- The issue of passporting however, is still high on the agenda, as banks that wish to continue providing services across the EU may have to relocate/restructure, unless a special arrangement can be negotiated.

- Furthermore, there is still increased uncertainty around the banking sector's future profitability as a result of the structural reform agenda.

- Profitability has been already suppressed by the current interest rate environment. This is more evident for large banks operating in the Euro area, as net interest income makes up a large proportion of their income.

- The average RoE across Europe's traditional banks has decreased to 1.7% as at the end of Q1 2017 (March 2016: 4.5%). This result is skewed by a number of less profitable banks such as UniCredit, Monte dei Paschi, Banco Popular Espanol and RBS. Excluding these from our analysis, the average RoE across Europe for March 2017 is 6.6% (Q1 2016: 5.3%).

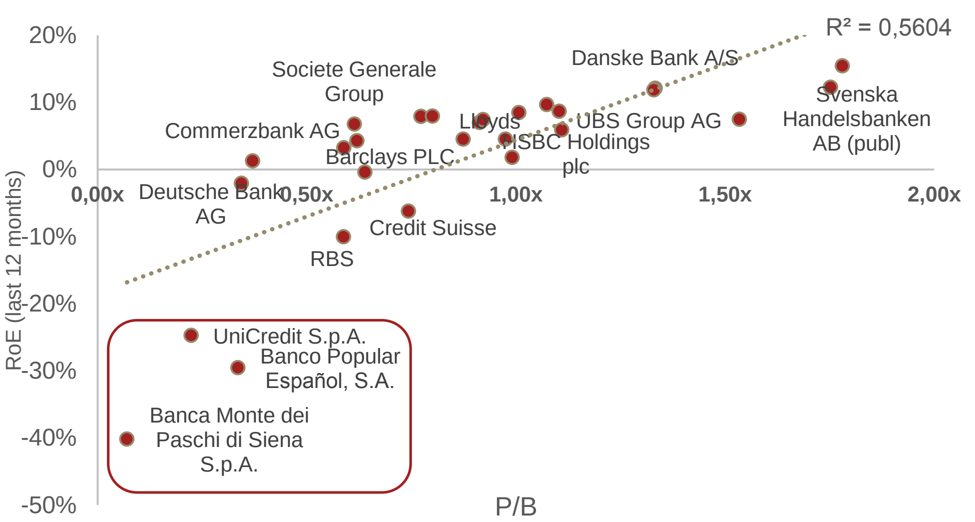
- In the period after the EU referendum, UK challenger banks have followed the P/B trend of UK high street banks, albeit trading at much higher multiples (March 2017: 1.9x).

- Challenger banks' average RoE has remained high throughout 2016 and Q1 2017, evidence of their well-defined, low-cost business models. These institutions have opted to specialise in niche areas of the market rather than offer a more traditional suite of products, and have thus been able to attract a wide range of customers.

Sector: Banking

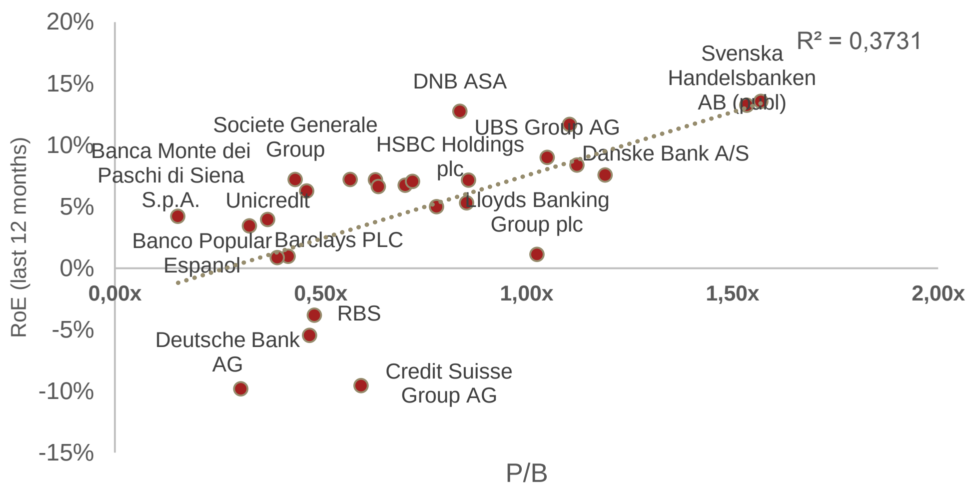
Given the improvements in European economy, the relationship between RoE and P/B multiples is beginning to normalise.

Figure 2: Selected quoted European banks' P/B against RoE (Q1 2017)



Source: Capital IQ, PwC analysis as at March 2017

Figure 3: Selected quoted European banks' P/B against RoE (Q1 2016)



Source: Capital IQ, PwC analysis as at March 2017

- The potential consequences of Britain's decision to leave the EU, along with factors such as regulatory pressure and negative interest rates, continue to impede the growth of European traditional banks.
- The year on year analysis suggests that despite the current uncertainty in the European banking sector, the relationship between RoE and P/B multiples (as measured by the correlation coefficient R^2 in our analysis) has improved (Q1 2017: 0.56, Q1 2016: 0.37).
- As the macro-economic environment in the market becomes more certain, we expect the correlation between the two performance measures to strengthen.

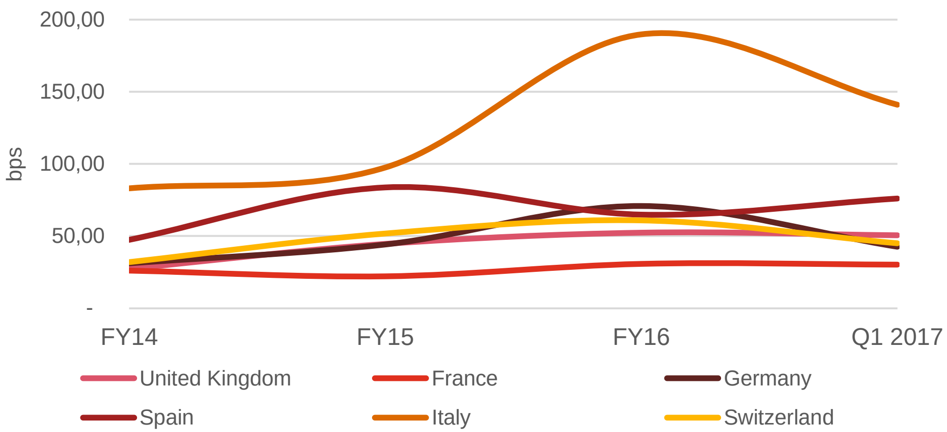
- In December 2016 Monte dei Paschi asked for state support after failing to raise €5.0bn on the market to shore up its capital position. The ECB has estimated that its current capital shortfall is €8.8bn, and the Italian government is expected to inject €6.6bn in exchange for 70% of the bank's share capital. Meanwhile, at the end of FY16 customer deposits were down 14% year on year highlighting the public's concerns over the bank's future.
- Banco Popular Espanol has also been in the spotlight after correcting its 2016 accounts two months after publication, posting a further loss of €240m over the original €3.5bn loss.

- UniCredit reported a loss of €11.8bn in its 2016 annual report (2015: €1.7bn) as a result of its plan to offload €18bn in bad debts. To compensate for this, in February 2017 the bank offered €13bn of ordinary shares to the public, resulting in a significant drop in the share price.
- In the UK, the latest BoE stress tests carried out in November have turned the market's attention on RBS, as under the worst case scenario it did not clear the required hurdles. On the contrary, Lloyds Bank has achieved a 5x increase in annual profits in Q1 2017 as compared to the previous year, due to restructuring its operations and de-risking a large part of its trading book.

Sector: Banking

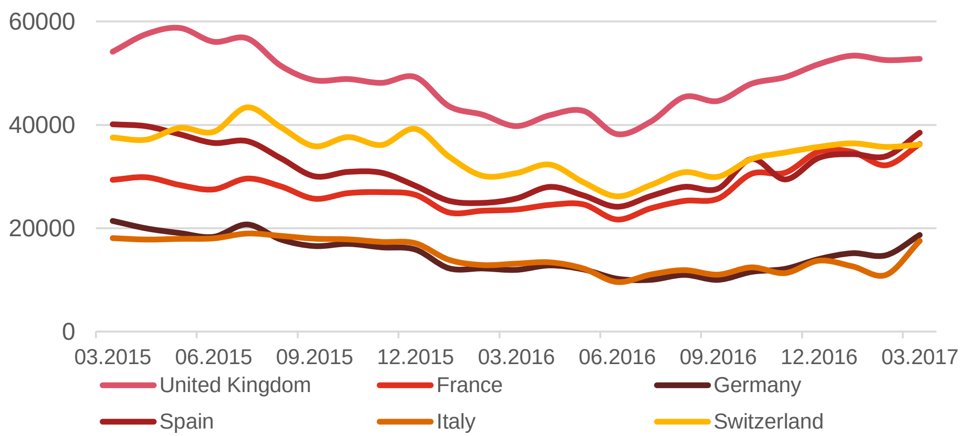
European banks' CDS spreads have been relatively stable (with the exception of Italy) and share prices have started recovering

Figure 4: One year CDS spreads on senior debt



Source: Capital IQ, PwC analysis

Figure 5: Average Market Capitalisation for European Banks (GBP m)



Source: Capital IQ, PwC analysis

- Despite the economic uncertainty in Europe and events such as the result of the British referendum, over the last 12 months European banks' CDS spreads have been relatively stable (with the exception of Italian banks).

- Italian banks however, have been struggling over the last few years as a result of the high volume of non-performing loans that remain on their balance sheets (c.€360bn). The recovery evidenced in Q1 2017 CDS spreads is due to the government's intention to bail-out problematic banks such as Monte dei Paschi. However, it is still unclear how and when this will happen as both the ECB and the European Commission must consent to the decision.

- The effect of the UK referendum result on UK banks' CDS spreads was relatively modest and not as severe as originally anticipated. Credit Suisse has reported that the UK is far from a credit crisis, and that CDS spreads and marginal funding costs have only shown moderate growth despite the sell-off in bank equity since the referendum result.

- Nevertheless, the future of UK banking is still uncertain as the path and effect of Britain's exit from the EU continues to be unclear. These issues will become more evident as the terms of Britain's exit from the EU have been agreed.

- European equity markets are showing signs of recovery as there is a general upward trend across the banks in our sample. However, dealing with regulatory change over the next few years could impede this growth.

- Overall, Europe's banking sector continues to go through a rather challenging phase. Matters such as Britain's access to the single market, Italian banking prospects and the forthcoming structural reforms are expected to shape the future of the sector. Also, further regulatory reforms such as IFRS 9 and the General Data Protection Regulation (GDPR) are on the way. Those that are able to adapt in a timely manner will be more strongly placed in the market.

Sector: Insurance

The UK non-life insurance industry remains robust in the wake of the EU referendum. However, with an EU market of over 500m people, passporting is a concern and insurers are already progressing restructuring initiatives by setting up EU subsidiaries.

Poor underwriting performance in the London market continues to be masked by FX gains

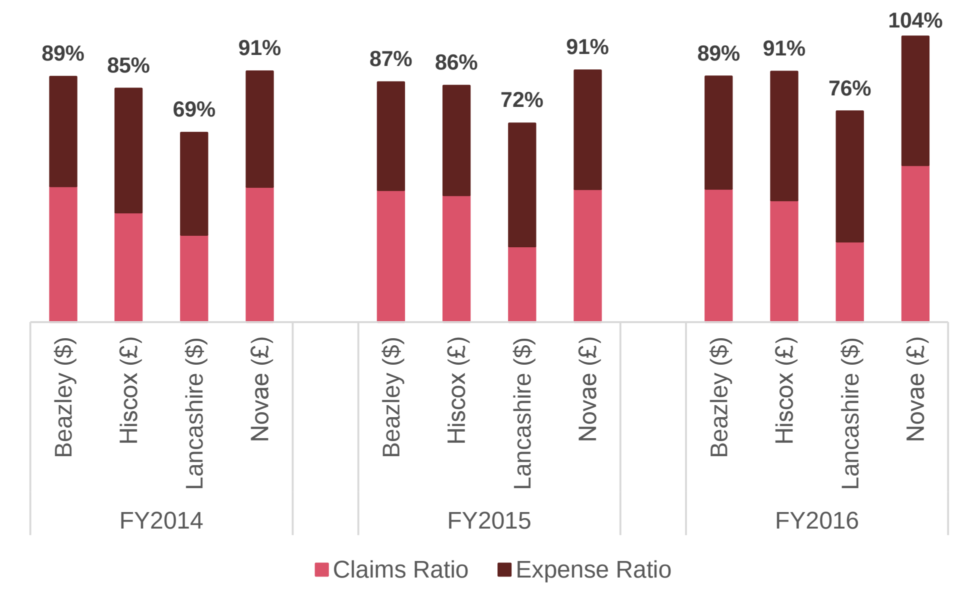
Lloyd's of London market quoted multiples have come down by c.20% in the last 12-18 months

The UK government's unexpected announcement of a sharp cut in the Ogden discount rate has caused reserving issues across the motor insurance market

Sector: Non-life insurance (London Market)

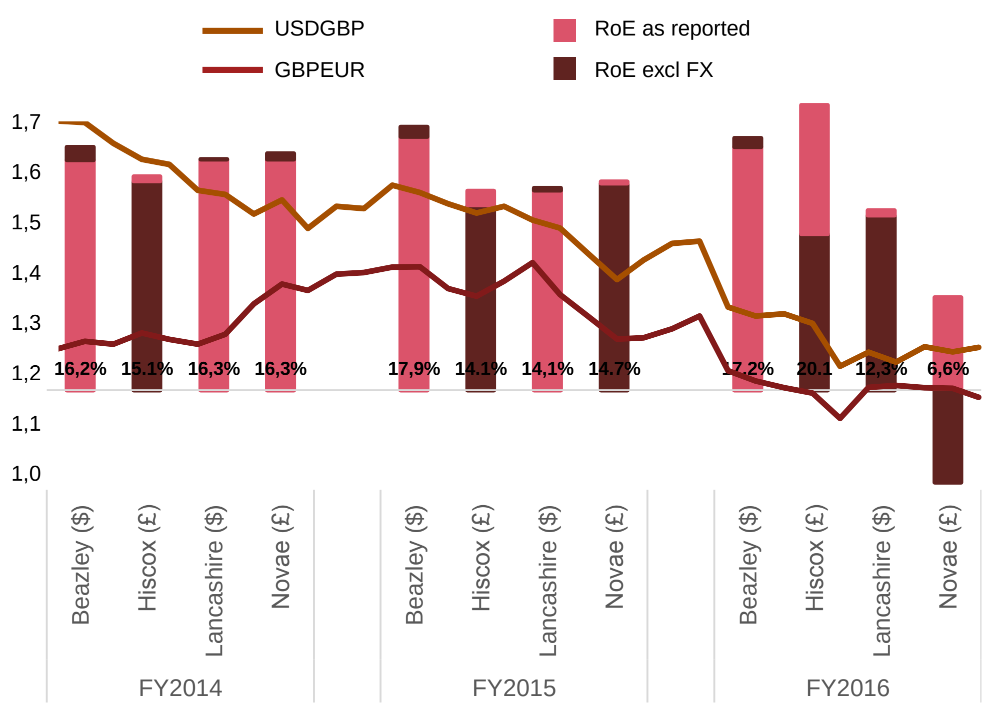
Poor underwriting performance in the London Market continues to be masked by FX gains

Figure 6 Lloyd's insurer combined ratios



- The continued soft market conditions have caused a gradual deterioration in observed combined ratios amongst Lloyd's Market players over the last few years.
- Roughly half of the Lloyd's syndicates posted higher expense ratios for 2016. Such increases have been the result of varying factors, including increased spending on acquisition costs, as well as additional overheads for Solvency II.

Figure 7 Lloyd's insurer RoE impact of FX gains

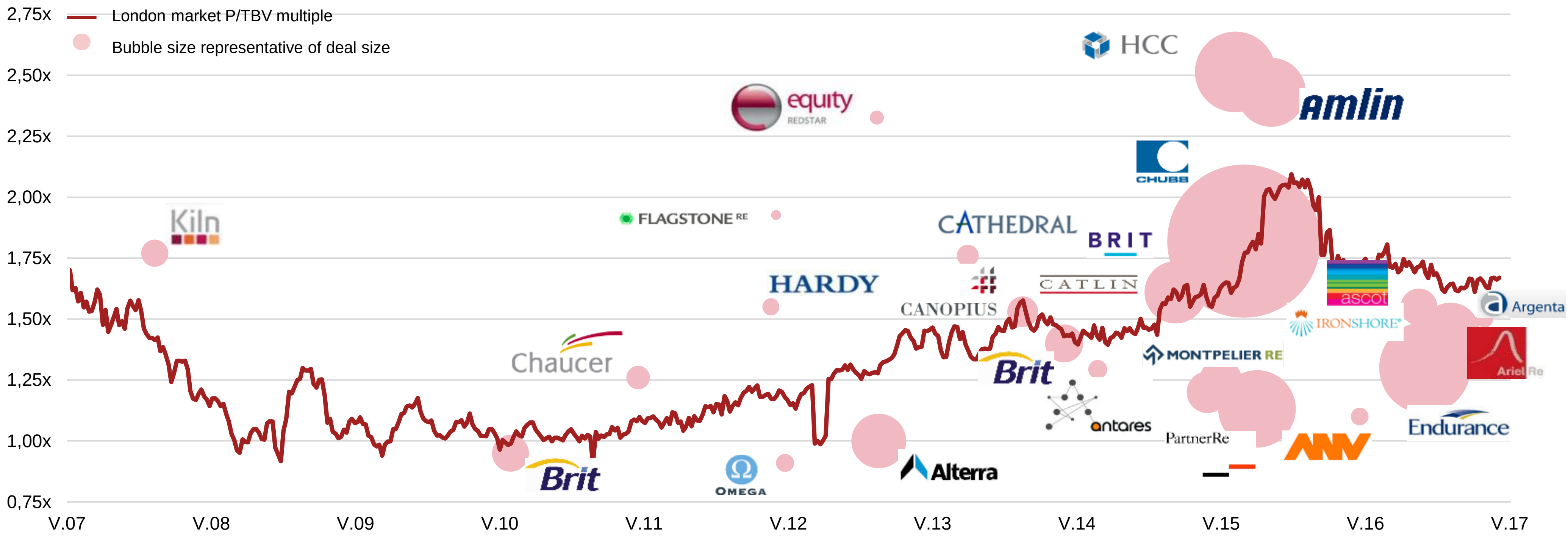


- Sterling-denominated Lloyd's of London players are enjoying the benefits of the weak pound as currency gains have flattered Return on Equity's ("RoE") by up to 30%. However, for higher RoE rates to be sustainable, insurers will need to regenerate fundamental RoE and boost growth by reinventing core business models, potentially triggering another wave of deals.
- The FY16 results of Novae were also adversely impacted by the changes made to the Ogden discount rate (more details on page 10). As a direct result of this change, the combined ratio rose from 98.3% to 103.6% and the RoE fell from 15.5% to 6.6% (Source: Novae Annual Report 2016).

Sector: Non-life insurance (London Market)

Lloyd's of London Market quoted multiples have come down by c.20% in the last 12-18 months, moving them closer to 'pre-Amlin' levels

Figure 8 Lloyd's insurer P/TBV multiples & deal activity



Source: Capital IQ, PwC analysis

- Following the flurry of M&A activity in 2015 and the subsequent upsurge in average P/TBV multiple of the key listed Lloyd's Market players, a slowdown in M&A was observed by early 2016 and a decrease in multiple closer to 'pre-Amlin' levels of c. 1.6-1.7x. This slowdown was reflective of management concerns over integration and how achievable synergies are.

- Despite challenging market conditions, Lloyd's insurers continue to attract interest. Argenta recently announced its proposed acquisition by European reinsurer, Hannover Re. Argenta also attracted interest from multiple other investors, particularly from China, who submitted significantly higher bids. Are uncertainties around deal execution and regulatory approval now pushing sellers to favour deal certainty over the highest bid?

Sector: Non-life insurance

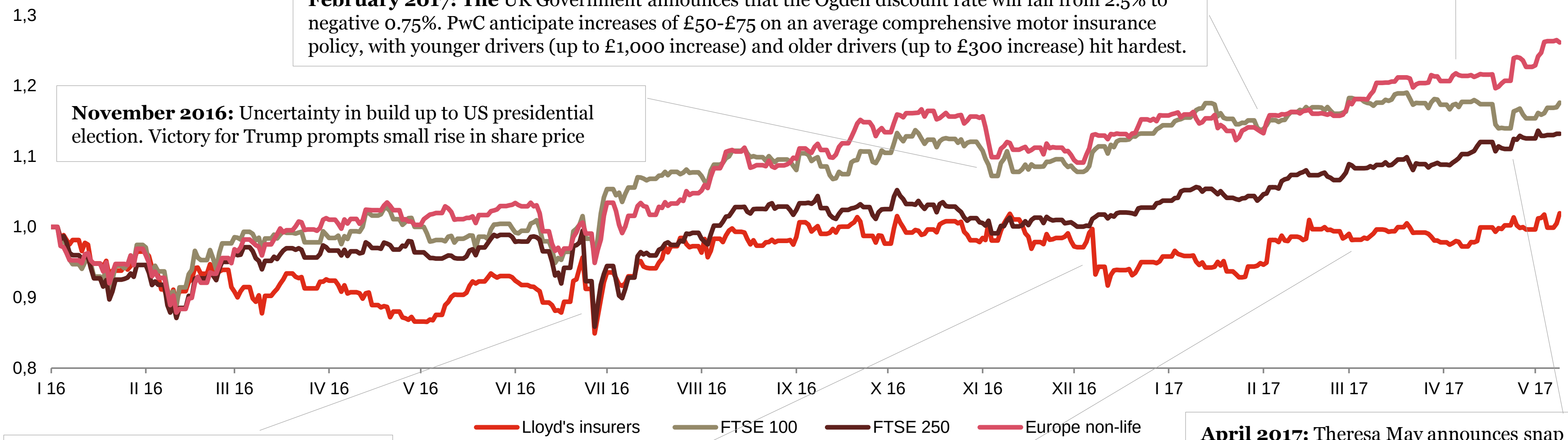
Share prices of non-life insurers have remained relatively steady despite a number of challenges, notably the EU referendum result and a sharp reduction in the Ogden rate.

Figure 9 Share prices of non-life and Lloyd's insurers

April 2017: The PRA requests that all insurers undertaking cross-border business in the EU respond with Brexit contingency plans by 14 July 2017. At this stage it is important that insurers have considered the implications of any proposed contingency plans e.g. to meet tax and regulatory requirements.

February 2017: The UK Government announces that the Ogden discount rate will fall from 2.5% to negative 0.75%. PwC anticipate increases of £50-£75 on an average comprehensive motor insurance policy, with younger drivers (up to £1,000 increase) and older drivers (up to £300 increase) hit hardest.

November 2016: Uncertainty in build up to US presidential election. Victory for Trump prompts small rise in share price



June 2016: The United Kingdom votes to leave the European Union.

April 2017: Theresa May announces snap general election on 8 June 17 to "make a success of Brexit".

December 2016: Novae issues 2016 profit warning due to "continued prevalence of larger individual risk and catastrophe losses".

March 2017:

- Lloyd's of London announces that is will set up an EU subsidiary in Brussels in order to "provide seamless coverage" to their customers in the wake of Brexit.
- The United Kingdom invokes Article 50 of the Treaty of the European Union, formally triggering the start Britain's withdrawal from the European Union.

Sector: Asset Management

The UK Asset Management industry has remained resilient in the face of political and economic uncertainty, turning to alternative strategies to maintain profit margins and growth

Assets under management (AUM) have continued to increase despite high levels of withdrawals from actively managed equity and property funds after the EU referendum

Trading multiples have very clearly recovered from their post-Brexit low of 6.2x, reaching a peak of 10.7x in October 2016 and remaining within the longer term range of 8x to 10x

The pressures to maintain profit margins and growth and to comply with regulation have led to high levels of M&A activity

Sector: Asset Management – UK

Assets under management (AUM) have continued to increase despite high levels of withdrawals from actively managed equity and property funds after the EU referendum

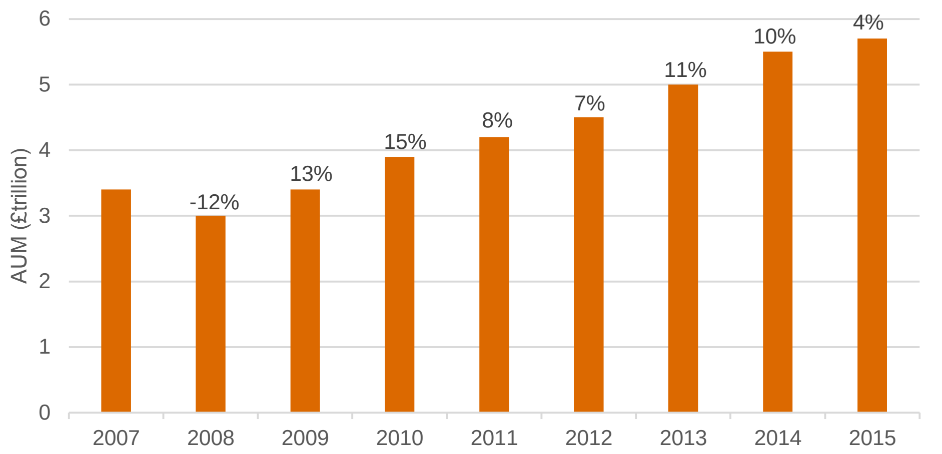
Recent trends

- The UK asset management industry has grown from £3 trillion in AUM as at December 2008 to £5.7 trillion as at December 2015 (figure 10), and currently stands at £6 trillion. This is despite high levels of withdrawals from actively managed equity and property funds after the EU referendum.
- Although overall AUM has continued to grow, caution amongst investors remains high as they move out of actively managed equity and property funds in favour of less risky products, such as mixed asset, fixed income and absolute return funds.

Key drivers of overall increase in AUM

- The cut in the UK interest rate to 0.25% in August 2016 has benefited the asset management industry as investors seek higher yields by deploying capital with asset managers rather than accepting low yields on cash deposits.
- Equity markets have continued to rally strongly post-Brexit despite an initial drop, with the FTSE250 reaching levels rivalling those recorded in 2015. This increase in the value of equities has translated into mark-to-market gains and therefore higher AUM.
- The overall depreciation of the sterling post-Brexit has increased the attractiveness of UK assets for foreign investors, and also boosted funds' performance when translating gains back to sterling.

Figure 10: Assets under management (AUM) by UK asset managers



Source: The Investment Association, PwC analysis

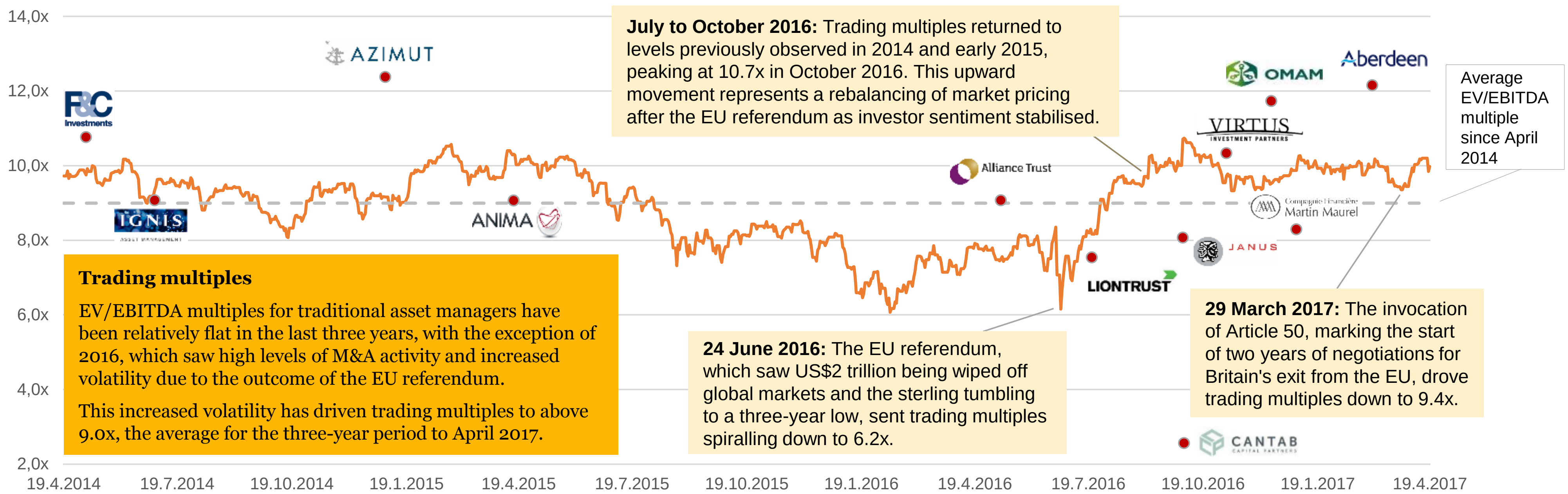
Notable market activity over the last twelve months

- Aberdeen Asset Management saw outflows of £1.5bn from its property funds in Q2 2016. Further outflows followed after Trump's victory in the US election. Poor market sentiment with regard to Standard Life's acquisition of Aberdeen has resulted in price target cuts from other asset managers, who argue that the merger offers little upside and substantial risk.
- Schroders has also seen massive withdrawals, reporting £1.1bn of net inflows for 2016, compared with £13bn in 2015. However, clients are starting to invest again after market uncertainty caused them to pull a net £2 billion out of equity funds in Q4 2016.
- Ashmore Group reported a 7% increase in AUM in Q1 2017, bringing total AUM to $55.9bn. The asset manager has benefitted massively from the depreciation of the sterling, as evidenced by its $2.3bn uplift from positive market movements and a net $1.4bn of new capital.

Sector: Asset Management – UK

Trading multiples have very clearly recovered from their post-Brexit low of 6.2x, reaching a peak of 10.7x in October 2016 and remaining within the longer term range of 8x to 10x

Figure 11: EV/EBITDA multiples for selected quoted traditional UK asset managers



Source: Capital IQ, PwC analysis

M&A activity

- 2016 and Q1 2017 saw high levels of M&A activity across the UK (figure 12), fuelled by intense competition and pressure on profit margins. Asset managers are looking towards consolidation to gain scale as an alternative means of increasing profitability.
- This trend is expected to continue as 52% of CEOs in the sector are looking to strategic alliances or joint ventures while 41% are considering a merger or acquisition.
- In addition to gaining scale to meet rising costs, regulatory responsibilities and investment needs, asset managers are also looking to consolidation as a way to break into new markets through buying talent.
- Technology and digitalisation also remain a key driver behind M&A activity as asset managers look to remain at the forefront of technological advances, e.g. Schroders's investment in Benchmark Capital's Best Practice network. The platform market and platforms requiring significant upgrades may be more likely acquisition targets.
- Asset managers are looking to future-proof their business by partnering or acquiring Direct-to-consumer or Robo-advice capabilities and upgrading front and back office platform technology.

Sector: Asset Management – UK

High levels of M&A activity and a trend from active to passive asset management signal a change in strategy for asset managers to maintain profit margins and comply with regulation

Figure 12: Selected M&A activity (2016 – 2017)

Acquirers	Targets	EV/EBITDA	Deal Rationale
GAM	Cantab Capital Partners	2.6x	Acquisition of Cantab's technology to enable GAM to launch a new quantitative investing platform
Liontrust	Alliance Trust Investments	9.1x	Acquisition of sustainable investment manager to meet consumer expectations around social responsibility
Henderson Group plc	Janus Capital Group	8.1x	Consolidation to achieve synergistic benefits, allowing Henderson a deeper, more scalable product offering
Standard Life	Aberdeen Simply asset management.	12.2x	Merger to achieve scale to invest for growth, innovate and drive greater operational efficiency / diversify offerings

Source: Capital IQ, Dealogic, PwC analysis

Regulation

- Greater regulation around transparency of pricing, e.g. with MiFid II due in January 2018, and fee structure has placed significant pressure on fee margins, particularly in Europe and for active managers. This pressure is expected to continue following the FCA's demands for more transparency and its proposals for all-in fees and absorption of research costs by asset managers.
- Tightening regulation has also forced changes in a number of areas such as fund product features, service provider arrangements, regulatory and investor disclosures, distribution channels, business models and compliance and risk management functions.
- The costs of responding to, and complying with, regulation could be further compounded by the uncertainty caused by Brexit.

Active vs. passive asset management

- The asset management industry has seen significant outflows from retail investors, in particular, from actively managed funds, which have not been able to exceed benchmark targets.
- The separation between alpha and beta currently observed in the industry will further accelerate as investors increase their investment allocation towards passive products in search of low management fees and broad beta market exposure. An analysis of the top 10 global asset managers over the past five years confirms this trend. BlackRock has also announced that it will reduce the number of its funds run by active managers as it responds to the threat from passives.

Outlook for the asset management industry

- Global uncertainty continues to dampen the market, e.g. the Eurozone crisis with upcoming elections in the UK and Germany, the results of the 2016 US election (impacts of which are still materialising) and the economic slowdown in China.
- Despite Brexit, CEOs in the asset management industry have ranked London as one of the three cities most important for growth in the next twelve months, suggesting that they believe London will remain a leading global financial centre.
- Much of the UK asset management industry's long-term future will depend on the negotiations around its EU passporting rights, the loss of which could see UK UCITS being recategorised as non-EU AIFs under the AIFMD. This means that these funds would be subject to additional marketing restrictions and become largely unavailable to retail investors in the EU.
- Demographic changes, such as the increase of high-net-worth-individuals from emerging markets, an ageing population in developed markets and the transfer of wealth from West to East, are creating strong long term growth prospects for the industry.

Appendix

The quoted companies used in our analysis (by sector):

Banks

HSBC Holdings plc (HSBC)
Deutsche Bank AG (Deutsche B)
Barclays PLC (Barclays)
Societe Generale Group (SOC Gen)
Commerzbank AG (Commerzbank)
Credit Agricole S.A. (Credit Agricole)
UBS Group AG (UBS)
BNP Paribas SA (BNP P)
Lloyds Banking Group plc (LBG)
The Royal Bank of Scotland Group plc (RBS)
Danske Bank A/S (Dankse B)
ING Bank Slaski S.A. (ING)
Banco Santander, S.A. (Santander)
Intesa Sanpaolo S.p.A. (Intesa)
Banco Popular Espanol S.A. (Banco PE)
Swedbank AB (publ) (Swedbank)
Banco Bilbao Vizcaya Argentaria, S.A. (BBVA)
Skandinaviska Enskilda Banken AB (publ) (SEB AB)
Natixis (Natixis)
Credit Suisse Group AG (C.Suisse)
Mediobanca Banca di Credito Finanziario S.p.A. (Mediobanca)
Banca Monte dei Paschi di Siena

Insurance Companies

MS Amlin plc (MS Amlin)
Hiscox, Ltd. (Hiscox)
Beazley plc (Beazley)
Novae Group Plc (Novae)
Lancashire Holdings Limited (Lancashire)
Catlin Group Ltd. (Catlin)
Endurance Specialty Holdings Ltd. (Endurance)
RenaissanceRe Holdings Ltd. (RenRe)
XL Group plc (XL Group)
Allied World Assurance Company Holdings, AG (Allied World)
AXIS Capital Holdings Limited (AXIS)
Mapfre SA (Mapfre)
Talanx AG (Talanx)
Validus Holdings, Ltd. (Validus)
Aspen Insurance Holdings Ltd. (Aspen)
Admiral Group plc (Admiral)
RSA Insurance Group plc (RSA)
Euler Hermes Group SA (Euler Hermes)
Everest Re Group Ltd. (Everest Re)
Arch Capital Group Ltd. (Arch Capital)
Argo Group International Holdings, Ltd. (Argo)
Direct Line Insurance Group PLC (Direct Line)

Asset Managers

Aberdeen Asset Management Plc
Ashmore Group Plc
Henderson Group Plc
Jupiter Fund Management Plc
Liontrust Asset Management Plc
Old Mutual Plc
Investec Plc
Standard Life Plc
Schroders Plc
F&C Asset Management Plc
Ignis Asset Management Ltd
Azimut Holding Spa
Anima Asset Management Ltd
Alliance Trust Plc
Cantab Asset Management Ltd
Janus Capital Group Inc
Virtus Investment Partners Inc
Banque Martin Maurel SA
Blackrock Inc
Benchmark Capital Advisors Inc
GAM London Ltd

Contacts

Albertha Charles
+44 (0)20 7804 5469
albertha.charles@pwc.com

Attul Karir
+44 (0)20 7213 4952
attul.karir@pwc.com

Nick Rea
+44 (0)20 7212 3711
nick.rea@pwc.com

Banking

Anna Cox
+44 (0)20 7804 1688
anna.b.cox@pwc.com

Peter Kuelsheimer
+44 (0)20 7804 4892
peter.kuelsheimer@pwc.com

Zoe Van Batenburg
+44 (0)7711 562475
zoe.f.vonbatenburg@pwc.com

Insurance

Nick Jones
+44 (0)20 7804 7019
nicholas.k.jones@pwc.com

Kevin McDonald
+44 (0)20 7804 3393
kevin.mcdonald@pwc.com

Sonam Magon
+44 (0)20 7213 1794
sonam.magon@pwc.com

Asset Management

Saleh Khan
+44 (0)20 7213 8923
saleh.m.khan@pwc.com

James Rowe
+44 (0)20 7212 8789
james.rowe@pwc.com

Hermione Lau
+44 (0)20 7212 3478
hermione.zoe.lau@pwc.com

Market Value Direct

Chris Heys
+44 (0)20 7804 2240
chris.heys@pwc.com

Nebil Shubbar
+44 (0)20 7804 3510
nebil.y.shubbar@pwc.com

Alexandros Hadjikyriakos
+44 (0)20 7212 2052
alexandros.hadjikyriakos@pwc.com

Strategic Value Consulting

Abhi Shah
+44 (0)7753 463365
abhi.shah@pwc.com

Ralph Dodd
+44 (0)20 7213 2413
ralph.s.dodd@pwc.com