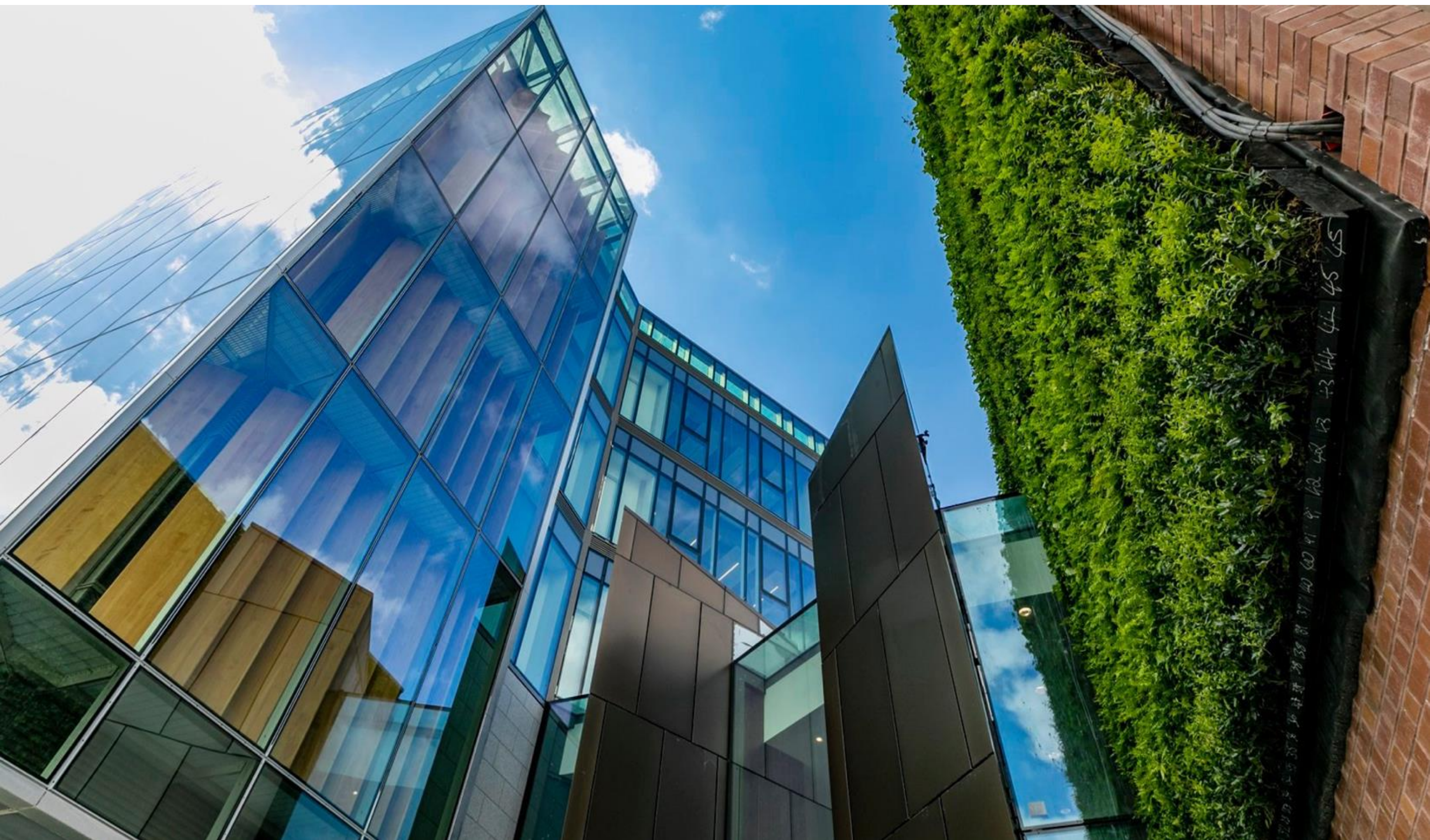
Trinity Student Managed Fund
Sector Reports

Financial Non-Banks

September 2024



TRINITY SMF
STUDENT MANAGED FUND

Table of Contents

Sector Overview - 3
Subsectors - 6
Investment Themes – 9
Headwinds - 10
Current Holdings - 11
Case Study - 15
Outlook - 18

Authors

Joshua Griffin
Sector Manager

Hannah Carney
Senior Analyst

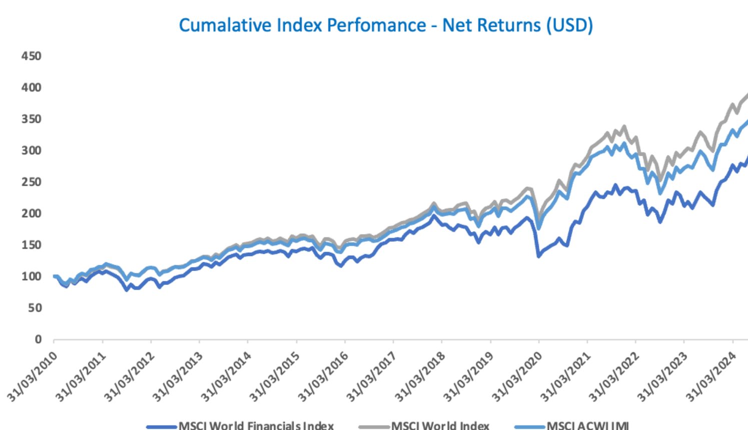
Seamus Kavanagh
Senior Analyst

Sector Overview

Non-Bank Financial intermediaries, also known as Non-Banking Financial Institutions (NBFIs), refers to financial institutions that offer an array of various financial services without possession of a banking license (1). NBFIs can be differentiated from other companies through the definition provided by the Dodd-Frank Wall Street Reform and Consumer Protection Act as companies "predominantly engaged in financial activity" as more than 85% of their consolidated annual gross revenues or assets are financial in nature (2). Common examples of NBFI's include asset managers, investment services, insurance, leasing, and credit as well as payment system operators. As such, each of these institutions operates under unique business models, balance sheets, and governance structures, and subject to differing regulations depending on their jurisdiction. These institutions are becoming increasingly vital in providing financing to the real economy and managing the savings of households and businesses, They offer a valuable alternative to traditional bank operations and play a crucial role in supporting real economic activities.

Stocks in the sector typically follow trends in the overall market and are cyclical in nature, responding to changes in demand for financial services. This results in Non-Bank stocks experiencing higher volatility than non-cyclical stocks such as consumer staples, which perform regardless of macroeconomic conditions as they are always in demand. In the event of a recession, when disposable income is scare, individuals are less likely to invest their finite amount of money in financial services that may be seen as a luxury. Conversely, if the economy is in a state of growth, cyclical stocks typically benefit more than non-cyclical stocks. It is also important to note that while financial services is broadly a cyclical sector, some NBFI's, such as insurance providers and brokers, are less dependent on strong macroeconomic conditions as insurance premiums must be paid periodically and are not typically considered to be luxury goods.

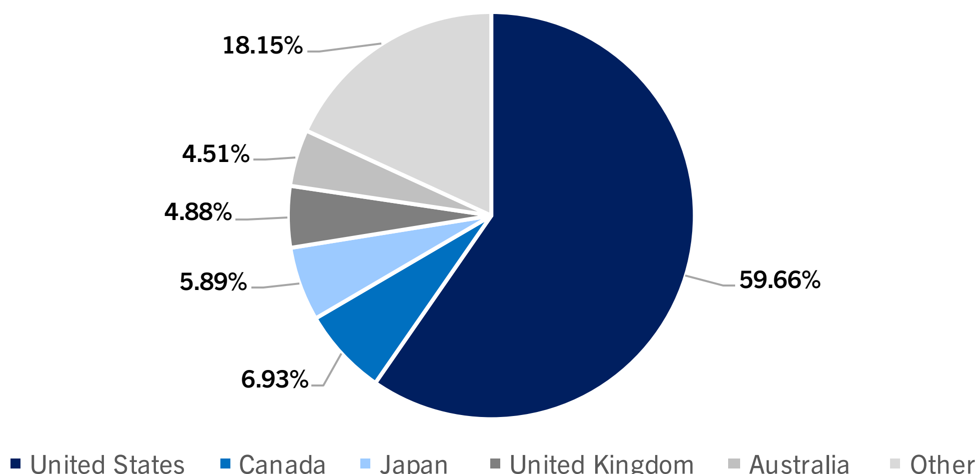
Sector Performance



Year	MSCI World Financials	MSCI World
2023	16.16	23.79
2022	-10.19	-18.14
2021	22.87	21.82
2020	-2.84	15.9
2019	25.51	27.67
2018	-16.97	-8.71
2017	22.74	22.4
2016	12.47	7.51
2015	-3.37	-0.87
2014	3.12	4.94
2013	27.33	26.88
2012	29.36	15.83
2011	-18.49	-5.54
2010	4.61	11.76

The Financials sector is a monumental sector, constituting 15.4% of the MSCI World Index, making it the second largest sector in the index, only behind the booming Information Technology industry at 24.98% (3). The sector has managed to recover successfully from difficulties associated with the market downturn experienced during the COVID-19 global pandemic, growing by 16.4% year-to-date, outperforming the World Index (4). This strong recovery is heavily influenced by the retreat of interest rates from the record-high inflation, with the EU and US Consumer Price Indexes reaching peaks of 10.6% and 11.1% in 2021 and 2022, respectively. As CPI has fallen to more reasonable levels of 2.9% in the US and 2.6% as of the time of writing, the sector has benefited from lower credit risk, decreased operational costs as well as positive impacts in important subsectors such as insurance, which has been able to experience lower cost of claims in comparison with previous years, resulting from prices of assets and labour decreasing in tandem with lower inflation rates. As seen in the MSCI World Financials Index, the Financial sector has experienced consistent growth since 2009, successfully navigating many turbulent periods and shocks to the market. This development has been driven by lenient regulations in comparison to Banking counterparts, allowing for more room in which to grow.

Weighting by Region



The United States hold a dominant share of the financials market, constituting almost 60% of the MSCI World Financials Index, with the United Kingdom, Canada, Japan, and Australia making large contributions as secondary players. Less than one fifth of the Financials sector is contributed by the remaining global share, largely contributed by companies in developed markets within Europe and Asia-Pacific. It is crucial to note that the aforementioned data accounts for both Banking and Non-Banking activities. This is of particular importance when viewing US market share as JP Morgan Chase, Bank of America, Wells Fargo, and Citigroup dominate the banking sector, cementing its place as the largest sub-industry in the sector.

Key Players

Prominent Non-Banks constituents within the Financials sector include Berkshire Hathaway B, Visa A, Mastercard A and S&P Global, constituting weightings of 5.54%, 4.05%, 3.72%, and 1.50% respectively, exerting significant influence on the MSCI World Financials Index.

Name	Industry	Region	Index Weight (%)	Ticker	Market Cap (billions)	52-Week Range	P/E	Beta
Berkshire Hathaway B	Capital Markets	US	5.54	BRK.B	$979.71	$330.58 - 459.27	14.45	0.87
Visa A	Financial Services	US	4.05	V	$529.96	$227.78 - 290.96	28.75	0.95
Mastercard A	Financial Services	US	3.72	MA	$432.95	$359.77 - 490.00	35.83	1.09
S&P Global	Financial Analytics	US	1.5	SPGI	$157.13	$340.49 - 505.85	47.63	1.16

*Metrics provided by Visible Alpha, current as of 28/8/2024

When examining potential investment opportunities, it is crucial to identify key stock performance metrics and what they may forecast an equities future. The 52-Week-Range represents the highest and lowest prices that a stock has traded at over the previous twelve months (5). Investors can use this indicator to determine a good entry or exit point for a position. For example, if Berkshire Hathaway B's price begins to surpass $460, investors may see this as an entry opportunity as there is reason to believe that the stock price has momentum to continue to travel upwards.

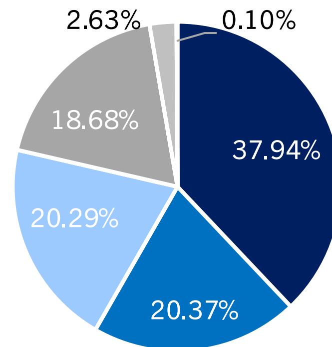
The Beta coefficient is also important to consider when investing as it denotes the stock price's volatility in comparison to the rest of the market (typically the S&P 500 index) (6). Beta effectively describes the movement of a stock in response to swings in the market. For example, Mastercard A has a beta of 1.09. meaning that if the overall market is to move up or down by one point, MA will increase or decrease by 1.09 points. If a company has a beta close to 1, it typically denotes that the stock is not highly volatile and responds normally to changes in the market. While a stock with a low Beta may carry very little risk for a portfolio, it also could limit potential to outperform the market and weaken returns in times of growth.

Additionally, the Price-to-Earnings (P/E) ratio represents the relationship between a stock's current price and its earnings per share, indicating how much investors are willing to pay for a piece of earnings generated. For example, S&P Global has a P/E ratio of 47.63, demonstrating that investors are willing to pay $47.63 for every dollar of earnings generated. This metric is an indicator of how the market values a stock relative to its earnings potential. A high P/E ratio, such as S&P Global, suggests that investors have high confidence in a stock's prospects and there is a heightened expectation of strong growth.

Subsectors

When examining the Financial Non-Banks Sector, it is important to break the sector into key segments and analyze the drivers that push these sub-industries as well as key performance indicators (KPIs) to observe when finding potential investment opportunities.

Sub-Industry Weights



Insurance

The largest of the Non-Bank Financial sub-industries, trailing only Banking in share of the global financials market, insurance provides businesses and individuals protection against a multitude of potential risks. This protection is funded through the periodic collection of insurance premiums from policyholders, creating a fund of which claims are paid out in the event of losses or damages. Insurance companies also carry out investment operations in order to increase profitability as well as aid in reducing the cost of insurance.

When examining firms within the sector, it is crucial to differentiate between insurance providers and brokers. Unlike providers, who receive premiums in exchange for taking on a policyholder's risk, brokers negotiate with providers on behalf of a client, looking to guarantee the lowest quoted premiums for a combination of protection types (7).

The growth of the insurance sector is heavily influenced by a mixture of broad macro and microeconomic factors. From a macro point of view, strong economic growth incentivises individuals and businesses to protect against potential uncertainties, boosting demand for insurance products. When paired with evolving regulatory and technological advancements, the insurance sector is situated in an ideal position for growth. Similarly, demographic changes such as population growth and urbanisation lead to increased need for essential protections, encompassing property, health, motor, and many more. Emerging markets also present growth opportunities for the sector with companies tailoring insurance products to unique preferences associated with different regions. With evolution comes the emergence of new dangers, most prominently cyber risks and climate change, incentivizing insurance firms to create specialized solutions for clientele.

Alongside rampant inflation, particularly in medical care costs, aging populations around the globe, and the high frequency of natural disasters and extreme weather events experienced during previous years, these drivers influence the evolution of traditional insurance operations and create a need for innovative products and protections.

To evaluate an insurance company, attention must be paid to a specific KPIs encompassing various metrics. Important KPIs in the Insurance industry include the loss ratio, premiums written and earned, retention rate, return on equity (ROE), expense ratio, solvency ratio, claims settlement ratio, and net promoter score (NPS) (8).

Capital Markets

Capital market institutions occupy a crucial role in the NBFI ecosystem, providing the essential infrastructure, services, and regulatory oversight necessary to facilitate the issuance, trading and exchange of various financial instruments including stocks, commodities, bonds, and derivates. The most prominent forms of capital markets institutions include stock exchanges, regulatory bodies, and holding companies. The capital markets sub-sector is heavily influenced by changes in macroeconomic climate such as interest rates, inflation, and geopolitical tension as these factors can drastically alter investor and asset valuations.

Primary source of income for companies in the sector is from processing and transaction fees, as well as commission earned from hosting the trading of assets on their platforms. Many large players in the sector may also provide expert market analysis and intelligence, drawing from their archive of trading activity, to clients in exchange for consultation fees. Paired with innovative tech solutions such as AI-based market analytics, capital market firms have found alternative methods to generate revenue while aiding investors in making informed decisions prior to entering a position in the market (9).

KPI’s required for a comprehensive analysis of a company within the capital markets subsector include trading volume, market share, operational efficiency, customer retention, average transaction value, liquidity ratio, net new assets (NNA), compliance rate, and number of active traders.

The growth of the capital markets is directly tied to key drivers of the global economy. Evolution of technology allows the improved efficiency and scale of trading platforms, as well as allowing for the improvement of modern methods of investing such as algorithmic and AI trading tools. Technological advancement also contributes to the globalization of the financial markets. While drawing in new investors and giving creating a more interconnected market, geopolitical events and macroeconomic trends hold increased influence on the capital markets industry. The sector is also highly responsive to regulatory changes, drastically effecting the landscape of the markets, observed with the newfound demand for sustainable finance as regulators attempt to foster market integrity and harbor positive innovations.

Consumer Finance

The consumer finance industry specialises in providing financial solutions which empower individuals to make purchases that may have otherwise been out of reach, as well as manage their finances and achieve their personal and financial goals. Consumer finance companies act as an attractive alternative to traditional payment methods, creating products to satisfy the unique needs of shoppers. Prominent types of consumer finance solutions included installment plans, Buy Now, Pay Later (BNPL), revolving credit (credit cards), and Business to Business (B2B) financing.

Consumer finance operations generate revenue from a plethora of sources with the most prominent earnings generated from interest attached to credit and loans extended to customers. Additionally, fees relating to late payments, overdrafts, transactions, annual memberships, and loan origination contribute significantly to revenue streams (10).

When assessing company performance within this sector, KPIs play a pivotal role. Key indicators include net interest margin, loan-to-deposit ratio, delinquency and default rates, customer lifetime value, cost-to-income ratio, first payment default rate, customer retention, portfolio growth rate, average loan value, and regulatory compliance rate.

The consumer finance sector has performed strongly over previous years, as consumer demand for alternative and accessible financial solutions propel the sectors growth. Innovations in financial technology have disrupted the sector, with companies providing alternatives to traditional consumer finance methods with digital products such as online lending platforms, virtual wallets, and AI driven financial services. The improved user experiences and lower fees typically associated with these offerings have found popularity among the public, propelling growth of the sector.

The landscape of the industry is highly dependent on the overall economic climate as factors such as changing interest rates greatly influence demand for credit and sentiment among borrowers. The consumer finance sector also has a need to constantly adapt and improve its financial products and services, whether that be because of regulatory changes affecting how firms can operate, or demographic factors such as population growth resulting in a necessity to create products tailored to specific consumer groups.

Investment Themes

Disruption of Artificial Intelligence and Blockchain

Evolving consumer preferences and landmark developments in financial technologies are driving the growth of the non-bank sector, particularly Fintech companies which have benefited hugely from breakthroughs in artificial intelligence. AI is now being harnessed to improve efficiency of financial operations through new risk assessment methods, automation of financial processes, and the improvement of consumer experiences through AI powered chat bots (11). Blockchain technology, meanwhile, is disrupting traditional financial institutions, creating an alternative pathway for financial services with unmatched security and transparency. Through advancements in financial technology, NBFIs are able to offer their services to a wider demographic while reducing their operational costs, propelling growth of the sector.

Globalisation and Emerging Markets

Companies across the sector are expanding operations into emerging markets across the globe, particularly those with a growing economies and increased demand for financial services. For example, India's middle-class has grown around 6.3% a year since 1995 but is relatively underserved by financial companies when compared to other developed nations such as those in Europe and the US (12). investment into companies that are targeting growth opportunities or hold a strong international presence can generate huge returns for the SMF. Additionally, the move to companies in emerging markets will help reduce the fund's overall exposure to the US domestic market which currently holds a dominant share of the total AUM.

Sustainable Investing

The growth of ESG considerations is greatly influencing investment opportunities across all sectors, including non-banking financial institutions which are starting to prioritise ESG factors in their business models and decision making. With customers becoming more mindful of their carbon footprint and impact on the environment, NBFIs have embraced green finance with market leaders such as Visa pledging to reduce emissions by fully transitioning to renewable electricity in addition to maintaining carbon neutrality (13). Financial technology companies are also leading the way for eco-friendly practices in the sector, offering services to other companies which analyse the environmental impact of their operations, as well as neutralise their carbon emissions through more eco-friendly solutions or investment in emission reducing projects (14). When observing opportunities in the sector, finding NBFIs that are embracing greener practices will unlock substantial growth opportunities for the fund as consumers are placing increased importance on their involvement in financial services having a positive environmental impact.

Headwinds

Economic Slowdown

Several factors indicate a general slowdown in economic activity and increase in recessionary risk, both in the US and globally. The Federal Reserve has signalled that they will be cutting rates in the near future, prompted by a significant cooling in the labour market and slowdown in the resilient growth of the US economy (15).Resultantly, JP Morgan research analysts have upwardly revised their probability of a recession by the end of 2024 from 25% to 35%, while probability of recession by the end of 2025 remains at 45% (16). This increased risk poses a notable threat to the cyclical NBFI sector, under which many institutions rely on consumers' willingness to spend and invest their money. Although lower interest rates are a positive sign for leveraged institutions such as hedge funds and private equity, looming risk of economic downturn may also discourage corporate investment and hence reduce the level of activity for these firms.

Geopolitical Uncertainty

Despite hopes of rate cuts, the uncertainty surrounding geopolitical conflicts in the Middle East and in Ukraine is a barrier to investment. Corporations may remain reluctant to invest in new projects despite cheaper credit, and this negative sentiment could limit activity for private capital firms. At the same time, investors must be more cautious about the political impact of where they are putting their money and are being forced to reconsider the contents of their portfolios. The investment limitations posed by geopolitical tensions could therefore lead to an overall strain on the activities of asset managers and other capital markets firms.

Regulatory Environment

Due to the nature of activities in the NBFI sector, firms in this sector are subject to a huge amount of regulation. Authorities such as the FCA, PRA and PSR are regularly implementing new regulations to protect consumers and promote healthy competition in the sector, as well as investigating breaches of existing regulations. NBFI firms are therefore vulnerable to paying large amounts of money to settle legal proceedings, as well as the indirect costs that come from reputational damage if they are found guilty of regulatory breaches. For example, earlier this year Visa and Mastercard faced an antitrust lawsuit in the US over their transaction fees, and Mastercard is still facing a £10bn claim from UK regulators over a breach of EU competition law (17). Such cases are common in the NBFI sector, and firms can incur large losses over regulatory breaches, negatively impacting investors' earnings as well as market sentiment.

Current Holdings – *Visa*

Company Overview

Founded in 1958 by Bank of America, Visa Inc is a San Francisco based global payments technology company that facilitates electronic funds transfers throughout the world with the use of its global transaction network, Visanet, connecting merchants, financial institutions, and consumers (18). In addition to payment processing, Visa also provide infrastructure to banks and financial institutions which support credit, debit, and prepaid card services. Visa also heavily invests in the development of digital payment technologies such as contactless payment and digital wallets, all created with a strong emphasis on customer protection and fraud prevention.

Visa is the second-largest card payment organisation in the world, only surpassed by China's domestic operator Union Pay. When excluding China, Visa commands a 50% global market share, surpassing its key competitor in the US and EU markets, Mastercard.

Stock Performance

Metric	August 2019	August 2024
Stock Price	$174.92	$276.37
Earnings per share (TTM)	$4.78	$9.35
Dividend Yield	0.57%	0.76%

Entry Point (Q2 2022): $212.06

Return to Date : 23.27%

Economic Moat

Duopoly

The global payment processing market is dominated by Mastercard and Visa, accounting for almost 90% of all transactions outside of China, greatly preventing competitors from disrupting their positions as the cost of entry would be too prohibitive (19). Visa finds itself in a highly secure position with a constantly expanding portfolio of partner banks, Visa users, and Visa accepting merchants. As more individuals receive cards from banks, merchants are incentivised to join the network, influencing more banks to offer Visa cards, expanding Visa's reach and hold on the market, heightening the barrier to entry This position also enables Visa to offer attractive benefits to partnered banks who typically receive between 60% to 90% of transaction fees generated by Visa.

Scalable Business Model

Visa is able to its increase revenues year on year without a proportional increase in operating costs, thanks to several key factors inherent to its business model. Firstly, Visa operates a highly scalable business model in which the cost of processing additional transactions are relatively low in comparison to to the revenues generated from those transactions. This means that as volume increases, the additional revenue significantly outpaces incremental margins, expanding margins, resulting in free cash flow margin exceeding 53%. A surplus of free cash flow enables Visa to annually increase its dividend, growing every year since its IPO, as well as enabling the buy-back $12.2 billion in shares from investors (20). Secondly, Visa continually invests its profits into technology and automation with the goal of improving its operations. Advanced data analytics, machine learning, and AI all aid in improving the efficiency as well as the capacity of Visa's network, ultimately leading to lower operating costs and higher profit margins for the future.

Tailwinds

Decline of Cash Transactions

Particularly in economically developed nations, cashless transactions have become the new default with consumers more eager to utilize cards over cash when making purchases. Driven by the rise of contactless payments, card payments in the United Kingdom made up more than 65% of total transactions,(21) with this number expected to increase year-on-year both domestically and globally. This presents an entry opportunity for Visa into new markets which are traditionally cash centric, such as nations in Asia, Africa, and Latin America with cash-based transactions dropping from 59% in 2021, to 30% in 2023 propelled by the growth of bank access in the region, putting cards in the pockets of more consumers. This expansion has already begun with Visa trialing new payment systems in the Caribbean and South America as well as rapidly expanding its network of merchants accepting Visa cards.

Technological Innovation

To effectively capitalise on the rise of digital transactions around the globe, Visa recognises the importance of being at the forefront of payment innovations through the investment in new technologies such as AI and Blockchain, recently adding a deep learning authorisation service to their Visa Protect line of products, better protecting businesses and individuals from fraud (22). By constantly striving for improvement and innovation, Visa can be prepared to navigate new challenges associated with the growing digitilsation of financial transaction, ensuring they can maintain and grow their position as a market leader.

Global Economic Recovery

As economies rebound from turbulent times and high inflation, consumers appear to hold higher optimism resulting in increased willingness to spend. A McKinsey report revealed that US consumers are expected to increase their spending over the coming months, driven by confidence in the domestic economy and rising disposable income among citizens, reaching to $16.78 trillion in 2024 (23). As major drivers of payment volumes such as hospitality, travel, and retail all rebound and benefit from economic recovery, Visa is well-positioned to reap the rewards of increased consumer spending.

Headwinds

Regulatory Pressure

Governments and regulatory bodies are viewing Visa and the payment processing industry with increased scrutiny, heavily influenced by its duopoly with Mastercard and the exceptionally high margins Visa generates. In the EU, UK and Australia, limits have been imposed on the interchange fees for consumer credit and debit cards in response to accusations of overinflated fees by Visa and Mastercard. In the United States, the Credit Card Competition Act 2023 was passed, mandating that card issuing banks must provide debit cards to consumers that operate on two networks, with one being neither Visa or Mastercard, all in aim to enhance competition within the sector and lower costs for merchants (24). Visa has also found itself under increased pressure from the US Department of Justice for alleged monopolistic activities, blocking the company's acquisition of Plaid for $5.3 billion (25). Stricter regulations and legal action present a potential limitation of Visa's market dominance, negatively affecting revenue and profitability.

Slowing Growth

After a period of strong growth in between 2021 and 2023 with revenue reports consistently beating analyst expectations, growing over 23% in 2022, Visa anticipates that future growth will only be in the "lower double digits". This slowdown has already begun to show with Visa experiencing a rare miss on revenue reports in Q3 of this year. Many Visa insiders also appear hesitant about the company's growth, most notably Kelly Tullier offloading $6.1 million in shares at a price of $233 per share, significantly below market price at the time of $277 (26). While insider selling can be an indicator that executives believe the company and its stock price will underperform in the future, it can occur as a result of many factors not necessarily linked to stock performance.

Technological Disruption

The rise of alternative payment methods, such as buy now, pay later (BNPL) services, digital currencies, and direct account-to-account transfers, poses a threat to traditional credit and debit card networks. Digital wallets have gained huge popularity over previous years and appear to be Visa's most likely competitor for the future. However, while able to operate without the need for Visa's payment network, the majority of users choose to link their credit or debit cards to the services, either to use their card from their mobile devices with apps like Apple Pay or to fund their digital wallet accounts made with companies such as PayPal. Central Banks have also begun to explore the possibility of issuing digital currencies as society moves further away from cash transactions, potentially disrupting traditional payment networks over time (27). As we see consumers and businesses adopt these alternative payment methods, Visa could see a decline in transaction volumes through its traditional card network if it fails to adapt to the ever-changing financial transaction landscape.

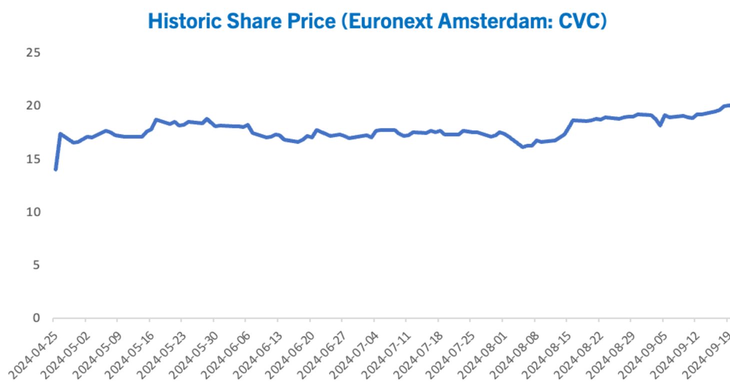
Oversaturation in Developed Markets

In many developed nations, Visa also already achieved a high level of market penetration with most consumers and businesses already using Visa products. This greatly limits the opportunities for further growth in these markets as much of the addressable market is served. The primary way to grow within these markets would be through innovation. By introducing new products or services, Visa can attract additional usage from its customer base. However, consumers within developed nations are already familiar and satisfied with Visa's core products base, making it harder to generate a strong return on investment when developing new products unless they have a significant impact. This leads to an overreliance on Visa to utilise emerging markets to drive revenue growth . While offering significant potential for growth, these regions also come with higher risk, including new regulatory challenges, economic and political instability, and lower levels of consumer trust in digital payments.

Case Study – *CVC Capital Partners*

Overview

CVC Capital Partners is a leading global private equity and investment advisory firm. Founded in 1981, CVC currently holds approximately €186 billion in assets under management, primarily focuses on acquiring significant or controlling stakes in companies. Their core strategy involves purchasing companies that they believe hold strong potential for growth if properly guided, working closely with management teams to enhance operational efficiency, increase market presence, and drive revenue growth. Currently invested in 130 private equity opportunities, CVC's main goal is to increase the value of managed companies over a long period of time before selling them for a profit.



Initial Public Offering:
€14

Current Price:
€19.14

Performance to Date:
36.7%

Strong IPO Execution

Debuting on the 26th April this year, CVC's IPO on Euronext Amsterdam was a huge success with stock price soaring up over 25% in its first day on the public market due to the strong investor support (28). Employees of CVC who own roughly 75% of the company also chose not to sell shares in the IPO, believing that the conservative price point of €14 would attract investors, enabling CVC to use shares as currency in future acquisitions following the rise in stock price (29).

Company Outlook

ECB Interest Rate Cuts

Private equity typically acquire companies through a process known as a leveraged buyout, essentially using a significant amount of borrowed money to purchase a company with the assets of the acquired and acquiring companies being held as collateral. LBO's allow buyers to make purchases that may have otherwise been cost prohibited, as well as presenting an opportunity to amplify returns due to the lower equity requirement for purchase (30). While making it cheaper for private equity firms to acquire companies during times of low interest rates, the increased interest rates experienced over previous years because of inflationary pressures drastically increased cost of acquisitions, preventing firms from purchasing new companies to manage, as well as offload assets. This resulted in a stall in the market with the private equity sector unable to expand portfolios or offload unsold assets valued at over $3 trillion (31).

This stall in the market does look fit to end due to the rebound of inflation rates to normal levels prompting central banks to begin interest rate cuts. This will effectively reduce the cost of debt financing and allow CVC and other Private Equity companies to shed some of their long-term portfolio and enter positions in promising opportunities.

What gives CVC the advantage over many of its American counterparts such is the European Central Bank choosing to cut interest rates ahead of the Federal Reserve, decreasing from 4% to 3.5% at the time of writing with possibility of further decreases (32). This will likely attract more mergers and acquisitions activity to Europe, allowing CVC to sell off some of its deep portfolio of strong companies to potential buyers.

Environmental, Social, and Governance Importance

In recent years, investors have begun to place high value on companies with strong ESG values, believing that sustainable business practices will promote growth for the long term and mitigate risk. This trend has also followed into the M&A market which despite high interest rates decreasing overall M&A activity, still has strong demand for low to mid value companies with a keen focus on ESG conscious practices. CVC is well positioned to profit from this demand due to the firm's focus on introducing sustainable and environmental conscious business practices into companies in their portfolio.

This move to greener financial practices can be observed through CVCs investment of €200 million in Paris based ESG risk monitoring company, EcoVadis, as well employing the outfits services in the rating of over 77% of CVC's portfolio (33). Through receiving risk data as well as guidance from EcoVadis on how to better promote the importance of ESG, CVC managed firms will likely be of higher quality than competitor's portfolio offerings, and ultimately of higher value when it comes time for an acquisition.

Digital Transformation and Technological Innovation

Launching its Growth strategy in 2014, CVC seeks to invest in middle-market, high-growth companies operating in the software and technology-enabled business services sectors and businesses where technology is used as a means to provide critical services to customers. This strategy is in response to the evolving digitalisation of industries around the globe. If CVC is able to target companies with a strong technological edge or those that can benefit significantly from digital integration, they can ensure that companies in their portfolio will experience strong growth for years to come, ultimately leading to higher values and improved profits for CVC.

Investment in Emerging Markets

CVC's investment strategy aims to find massive growth opportunities in emerging markets, developing companies to gain strong footholds in unsaturated regions such as India, an economy which has outpaced other world leaders in growth. CVC had been in search of major buyout opportunities following successful investments in the nation's healthcare and agrochemical sectors, as well as securing ownership of the Gujarat Tigers, a franchise of the highly successful IPL Cricket Organisation (34). In August of this year, CVC outbid EQT Partners, a key European competitor, for the acquisition of Aavas Financiers. The position aims to capitalise on the growing middle class and real estate sector of northern and central India, with Aavas expected to grow its AUM by over 23% by 2027.

Risks

Overreliance on Leverage

CVC often employs significant leverage when financing acquisitions. While this may amplify returns from a company, it also increases the financial risk in the event of economic downturns (35). If highly leveraged companies fail to meet performance expectations, the debt burden may become unsustainable, potentially leading to defaults or bankruptcies. Leveraged buy outs also increase a company to risks associated with industry specific shocks. Unexpected shocks, such as those experienced in the real estate market following the 2008 financial crisis, can severely impact companies within a sector and seriously harm CVCs portfolio.

Regulatory Changes

The "private funds" industry has grown tremendously since 2008, exceeding the banking sector in total gross assets in the United States. Viewed as a lightly regulated industry for a long period of time, regulators have a closer eye on private equity, creating an evolving set of regulations that can impose additional compliance costs, restrict certain types of investments, or limit the use of leverage, all changes that will likely negatively affect CVC's profitability if unable to adapt.

Recent changes such as the "Private Fund Rule" require private equity firms to operate with increased transparency, mandating the publishing of quarterly financial reports to investors as well as annual audits on fund operations (36). The regulations also brought in restrictions on certain practices such as charging regulatory and compliance fees as part of the fund's expenses , only permissible if charges are fully disclosed to investors. While these new changes while result in higher compliance fees for private equity firms, it could also have benefit for established firms by increasing the barrier to market entry. With stricter rules, new entrants to the market will need more capital and experience to gain traction in the market.

Thesis Conclusion

Thesis: Buy

Given the opportunities presented by changing macroeconomic conditions such as lowering inflation and interest rates aswell as its expansion into regions set for high growth, CVC and its portfolio possess plenty of driver to ensure that stock price maintains on an upward trajectory for years to come. Coupled with its position as a market leader in the European private equity sector and the positive reception of its IPO earlier this year, CVC presents an early entry point into a potentially lucractive posititition for the SMF, generating large returns as CVC makes exits from its highly valuable assets in its portfolio over years to come.

Outlook

The outlook for the non-bank financial sector remains cautiously optimistic, driven by several key trends. Technological innovation and digital transformation continue to be major growth drivers, allowing NBFIs to enhance efficiency, customer experience, and market reach. However, the sector faces challenges such as increased regulatory scrutiny and the need for robust risk management practices, particularly in a fluctuating economic environment marked by varying interest rates and geopolitical uncertainties. As competition intensifies, particularly from fintech and big tech firms, NBFIs must innovate and adapt to sustain growth. Additionally, the growing emphasis on ESG factors is likely to influence investment strategies and operations, offering both challenges and opportunities. Overall, while the sector has strong potential for expansion, particularly in emerging markets and through digital channels, it must navigate a complex landscape of regulatory, economic, and competitive pressures to thrive.

Reflection

As the incoming management of the sector, we believe that strong growth can be experienced by diversifying our portfolio, crucially by moving away from US based mega-cap corporations. Currently, the sector is made up entirely of Visa, which while a successful investment for the sector, raises two important trends to move away from and find new avenues for growth.

Firstly, overreliance on mega-cap corporations. While attractive investments due to their dominant market positions and unmatched revenues, mega cap companies are not the be all and end all of investment opportunities and we believe that there is great value to find in the mid and low cap. For example, CVC Capital Partners has a market cap of only €20.25 billion, a fraction of Visa's $546 billion, and looks to be an undervalued entry point into a new market. One of the main goals of the sector over the next 12 months and beyond should be to find diamonds in the rough and uncover small companies that can generate big gains.

In addition, overexposure to the United States leaves the sector too reliant on strong US market performance. By looking at opportunities in other regions, the fund can better protect against any turbulence experienced in the US, particularly with everchanging regulatory and political climate in the nation. Branching out into new territories also presents potential lucrative early investment opportunities which can drive sector growth for years to come.

Disclaimer

The content presented in this publication is for informational purposes only and should not be considered as investment advice. The Trinity Student Managed Fund does not endorse, recommend, or provide any warranties regarding the accuracy, completeness, or reliability of the information provided herein. All opinions expressed in this publication are those of the respective authors and do not necessarily reflect the views of the Trinity Student Managed Fund.

Readers are strongly advised to conduct their own research and consult with qualified financial professionals before making any investment decisions. The Trinity Student Managed Fund disclaims any liability for any financial loss or damage arising from reliance on the information contained in this publication.

All rights to the content, including articles, artwork, and any other material published in this periodical, (exclusive of sources) are the exclusive property of the Trinity Student Managed Fund. Reproduction, distribution, or any other use of the content without prior written permission from the Trinity Student Managed Fund is strictly prohibited. For inquiries regarding the content or permission to use, please contact admin@trinitysmf.com.

References

1. Financial Stability Board. (2024). *Work of the FSB - Non Bank Financial Intermediation* https://www.fsb.org/work-of-the-fsb/financial-innovation-and-structural-change/non-bank-financial-intermediation/
2. Chen, J. (2024). Investopedia. *Nonbank Financial Institutions: What They Are and How They Work* https://www.investopedia.com/terms/n/nbfcs.asp
3. MSCI. (2024). *MSCI World Index Factsheet.* https://www.msci.com/documents/10199/178e6643-6ae6-47b9-82be-e1fc565ededb
4. MSCI. (2024). *World Financials Index Factsheet* https://www.msci.com/documents/10199/1b3a3205-7804-40b1-9471-6b75081b4efe
5. Chen, J (2021). Investopedia. *52 Week High/Low: Definition, Role in Trading and Example* https://www.investopedia.com/terms/1/52weekhighlow.asp#:~:text=52%2DWeek%20Range%3A%20Overview%2C,course%20of%20a%20trading%20day.
6. Kenton, W. (2024). Investopedia. *What Beta Means For Investors* https://www.investopedia.com/terms/b/beta.asp
7. Tisdale, J. (2023). Zensurance. *Insurance Broker vs. Insurance Company: What's the Diffference?* https://www.zensurance.com/blog/insurance-broker-vs-insurance-company-whats-the-difference
8. Insightsoftware. (2024). *28 Best Insurance KPIs and Metrics Examples for 2024 Reporting* https://insightsoftware.com/blog/best-insurance-kpis-and-metrics/

References cont'd

9. Finley. (2024). *Picking the RIght Capital Market KPIs* https://www.finleycms.com/blog/picking-the-right-capital-markets kpis#:~:text=What%20are%20Capital%20Markets%20KPIs,to%20stakeholders%20across%20the%20company.

10. Singla. M. (2018) CULytics. *Top KPIs for Consumer Lending* https://culytics.com/blogs/kpis-for-consumer-lending

11. Shoushany, R. (2023). Forbes. *How Fintech and Blockchain Are Evolving And Disrupting Financial Institutions* https://www.forbes.com/councils/forbestechcouncil/2023/01/31/how-fintech-and-blockchain-are-evolving-and-disrupting-financial-institutions/

12. Doma Bhutia, P.(2024). Skift Megatrends 2024. *Is the World Ready to Meet the Indian Middle Class* https://skift.com/2024/01/09/is-the-world-ready-to-meet-the-indian-middle-class-megatrends-2024/#:~:text=The%20middle%20class%20now%20represents,2031%20and%2060%25%20by%202047.

13. Visa. (2020). *Visa Reaches 100 Percent Renewable Electricity Goal* https://investor.visa.com/news/news-details/2020/Visa-Reaches-100-Percent-Renewable-Electricity-Goal/default.aspx

14. Gehrke, N. (2024). Medium. *Carbon credit trading platform Carbon EX exceeds 900 registered companies* https://medium.com/tokyo-fintech/carbon-credit-trading-platform-carbon-ex-exceeds-900-registered-companies-e9dfc46cc6d5

15. Saphir, A. (2024). Reuters. *Fed seen poised for September rate cuts as inflation cools* https://www.reuters.com/markets/rates-bonds/traders-see-fed-delivering-25-bps-cut-sept-100-bps-by-year-end-2024-08-30/

16. J.P. Morgan. (2024) Global Research. *The probability of a recession now stands at 35%* https://www.jpmorgan.com/insights/global-research/economy/recession-probability#:~:text=Global%20recession%20outlook,by%20the%20end%20of%202025.

17. European Commission Press Release. *Antitrust: Commission accepts committments by Mastercard and Visa to cut inter-regional interchange fees* https://ec.europa.eu/commission/presscorner/detail/en/ip_19_2311

18. Vaughan, D. (2024). Brittanica. *Visa Inc.* https://www.britannica.com/money/Visa-Inc

19. Westberg P. (2024). Quatr. *Visa and Mastercard: The Global Payment Duopoly* https://quartr.com/insights/company-research/visa-and-mastercard-the-global-payment-duopoly

20. Smith, P. (2023). Bloomberg. *Visa Beats Profit Estimates, Plans $25 Billion Stock Buyback* https://www.bloomberg.com/news/articles/2023-10-24/visa-tops-estimates-on-card-spending-plans-25-billion-buyback?embedded-checkout=true

21. Haan, K. (2024). Forbes. *People Are Twice As Likely To Spend More Money When Using Card Than Cash in 2024* https://www.forbes.com/advisor/business/software/people-twice-likely-spend-using-card-than-cash/

22. Visa. (2024). *Visa's Growing Services Business Infused with New AI-Powered Products* https://investor.visa.com/news/news-details/2024/Visas-Growing-Services-Business-Infused-with-New-AI-Powered-Products/default.aspx

References cont'd

23. McKinsey & Company. (2024). McKinsey Insights. *An update on US consumer sentiment: Consumer optimism rebounds - but for how long?* https://www.mckinsey.com/industries/consumer-packaged-goods/our-insights/the-state-of-the-us-consumer
24. Durbin, D. (2023). Office of U.S. Senator Dick Durbin of Illinois. *Short Summary of the Credit Card Competiton Act of 2023 2023* https://www.durbin.senate.gov/imo/media/doc/The%20Credit%20Card%20Competition%20Act%20of%202023%20-%20one-pager.pdf
25. U.S. Department of Justice. (2023). Antitrust Division. *Protecting Nascent Competition: Visa and Plaid Abandon Anticompetitive Merger* https://www.justice.gov/atr/division-operations/division-update-spring-2021/protecting-nascent-competition-visa-and-plaid-abandon-anticompetitive-merger
26. Simply Wall Street. (2024). *Visa Insiders Sold US$17m of Shares Suggesting Hesitancy* https://finance.yahoo.com/news/visa-insiders-sold-us-17m-140009672.html
27. Prodan, S. (2024). Heliyon. *The rise in popularity of central bank digital currencies. A systematic review* https://www.ncbi.nlm.nih.gov/pmc/articles/PMC11096978/#:~:text=Similar%20to%20traditional%20money%2C%20central,or%20virtual%20payments%20%5B10%5D.
28. Farr, E. (2024). Reuters. *Private equity group CVC shares soar on Amsterdam debut* https://www.wsj.com/finance/investing/cvc-capital-partners-prices-ipo-at-middle-of-range-targets-15-billion-valuation-9c91a4c7
29. Coben, C. (2024). Financial Times. *Why CVC's IPO was such a hit* https://www.ft.com/content/8760996b-b59e-4ecf-8f3d-973100e37b45
30. Precedence Research. (2024). *Private Equity Market Size, Share and Trends 2024 to 2033* https://www.precedenceresearch.com/private-equity-market#:~:text=The%20global%20private%20equity%20market,of%20the%20private%20equity%20market.
31. Cornerstone Business Services. (2024). *How high interest rates affect M&A* https://www.cornerstone-business.com/how-high-interest-rates-affect-ma/#:~:text=Elevated%20interest%20rates%20increase%20the,longer%20to%20close%20than%20normal.
32. Jolly, J. (2024). The Guardian. *ECB mulls second interest rate cut as eurozone inflation falls to 2.2%* <https://www.theguardian.com/business/article/2024/aug/30/ecb-mulls-second-interest-rate-cut-as-eurozone-inflation-falls-to 22#:~:text=ECB%20mulls%20second%20interest%20rate%20cut%20as%20eurozone%20inflation%20falls%20to%202.2%25,-Drop%20to%20lowest&text=Eurozone%20inflation%20fell%20this%20month,cut%20interest%20rates%20in%20September>
33. CVC Capital Partners. (2023). *ESG Report 2023* https://www.cvc.com/media/5dwknq5r/cvc_esg_report_2023.pdf
34. Construction World India. (2024). *CVC Capital outbid EQT to acquire Aavas Financiers for Rs 70 billion* https://www.constructionworld.in/policy-updates-and-economic-news/cvc-capital-outbid-eqt-to-acquire-aavas-financiers-for-rs-70-billion/60527
35. Fissette, J. (2024). Roundtable. *The Advantages and Risks of Leveraged Buyouts* https://www.roundtable.eu/learn/the-advantages-and-risks-of-leveraged-buyouts#:~:text=Financial%20Risks&text=One%20significant%20risk%20in%20leveraged,fluctuations%20could%20exacerbate%20financial%20challenges.
36. DeChesare, B. (2023). Mergers & Inquisitions. *Private Equity Regulation: 2023 Changes and Impact on Finance Careers* <https://mergersandinquisitions.com/private-equity-regulation/>