European Financial Services M&A Insight

May 2010

Welcome

to the second edition of European Financial Services M&A Insight for 2010.

The quarterly report aims to provide perspectives on the recent trends and future developments in the M&A market, including analysis of the latest transactions and insights into emerging investment opportunities.

Front cover image: Frankfurt skyline after sunset

Although the overall value of deals in the European financial services sector continued to be subdued in the first quarter of 2010, there was a steady flow of smaller and mid-market transactions. As we anticipated in our last edition, restructuring within the banking sector is continuing and private equity interest in various aspects of financial services is increasing. (See 'Data Analysis').

Already ripe for consolidation, EU competition rulings and growing political pressure are adding further impetus to the resurgence of M&A in the German banking sector. Although the returns for investors may take some time to materialise, Germany offers opportunities for synergies and market development that few other countries of this size and wealth can match. (See 'Stirring giant: M&A opportunities in the German banking sector').

One of the countries in which restructuring is likely to be most pronounced is Spain, where banks continue to be weighed down by bad debts, emanating from the collapse of the country's once booming property market. Institutions are looking to consolidation and divestment to help strengthen margins and rebuild their balance sheets, creating a range of opportunities for investment. There is also growing interest in the acquisition of non-performing loan portfolios. (See 'Market shakeout: Restructuring creates openings in Spain').

Some attractive acquisition targets are likely to come on to the market in the next few months as a number of government-supported groups seek to comply with European Commission State Aid conditions. Institutions that have been able to defend their independence and rebuild their capital ratios will be in a strong position to take advantage. The coming regulatory shake-up in the asset management sector also has the potential to spur deal activity. (See 'Looking Ahead').

We hope that you find this edition of Insight interesting. Please do not hesitate to contact either of us or any of the article authors if you have any comments or questions.

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Data Analysis

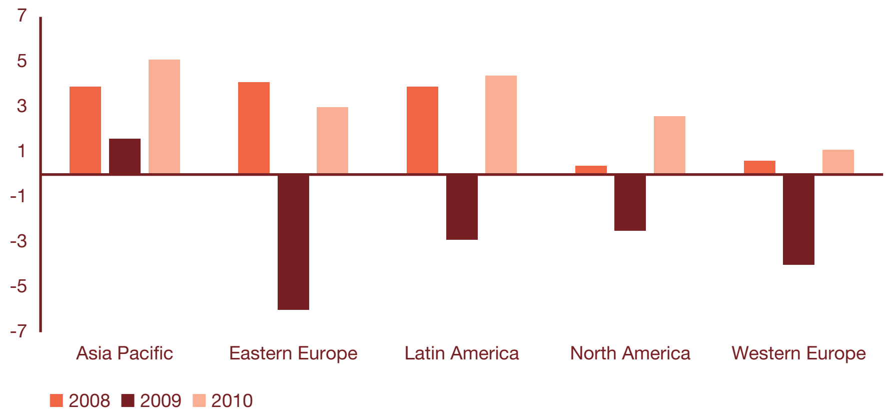
A slow start to 2010

The February 2010 edition of this paper reviewed M&A activity for the whole of 2009. With the transition to publishing this paper quarterly, this analysis now focuses for the first time on a single quarter of deal activity in European financial services.[1]

In common with other European industries,[2] M&A activity in financial services was low during the first quarter of 2010. This was in strong contrast to a range of substantial deal announcements in the Asia Pacific region, most notably Prudential's proposed acquisition of AIA for an anticipated value of €26bn.[3] In part, this reflects the comparatively weak economic recovery anticipated in Western Europe (see Figure 1).

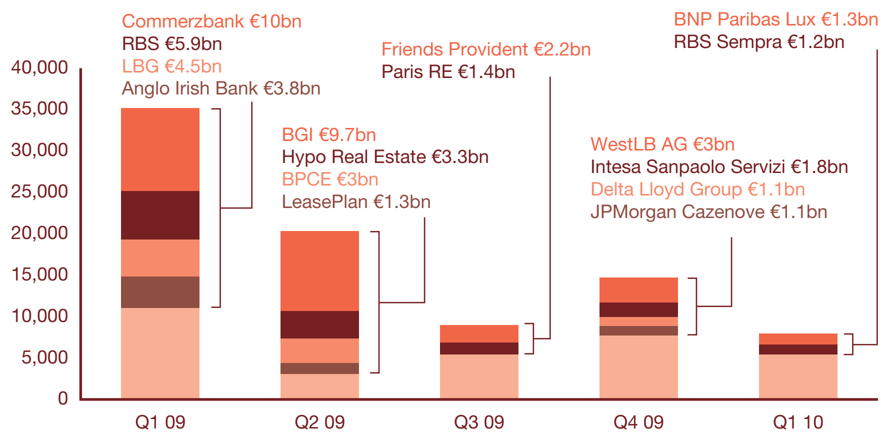
The quarter was particularly notable for the low number of high-value deals. Only two transactions were valued at more than €1bn, although small and mid-market deals continued to be announced. Overall, financial services' deals with disclosed values amounted to €7.8bn, less than any recent quarter (see Figure 2). This represents less than 10% of the €80bn recorded during the whole of 2009, although this increases to 19% when compared to private sector transactions in 2009.

Figure 1: GDP growth prospects by world region (%)



Source: PwC estimates and main scenario for 2009–10, UK Economic Outlook, March 2010

Figure 2: Quarterly European FS deals by value (€m)



Source: PricewaterhouseCoopers' analysis of mergermarket, Thomson Reuters and Dealogic data

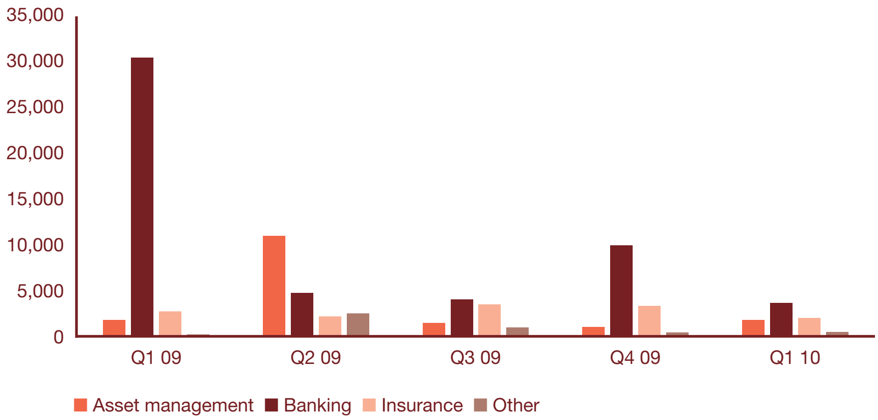
1 The source data on the deals analysed in this publication come from mergermarket, Thomson Reuters and Dealogic, unless otherwise specified. Our analysis methodology is summarised on P13.

2 'M&A surges in Asia while US and Europe suffer', Financial Times, 30.03.10

3 'Prudential plc agrees to buy AIA for $35.5 billion', Bloomberg, 01.03.10

Data Analysis
continued...

Figure 3: Quarterly European FS deals by value – subsector analysis (Including government led deals)



Source: PricewaterhouseCoopers' analysis of mergermarket, Thomson Reuters and Dealogic data

Continuing the trend that began in 2009, banking deals were much less dominant than often seen in the past (see Figure 3). Transactions involving banking targets accounted for 46% of deal value, compared to 25% for insurance transactions and 23% for asset management deals.

As expected, there was also a further decline in government-led activity. Government-funded deals amounted to just 4% of the quarter's total deal value, compared with 58% and 24% during the first and second half of 2009, respectively. The value of domestic and cross-border transactions was evenly balanced at 49% and 51%, respectively, although domestic deals were far greater in number (185 against 83).

Figure 4: Top 10 Deals Q1 2010

Month	Target	Target	Bidder	Bidder	Deal value (€m)
Mar	BNP Paribas Luxembourg SA (46.54%)	Luxembourg	BGL BNP Paribas	Luxembourg	1,339
Feb	RBS Sempra Commodities LLP (European and Asian operations)	United Kingdom	JP Morgan Chase & Co	USA	1,235
Feb	Pantheon Ventures Limited	United Kingdom	Affiliated Managers Group Inc	USA	564
Jan	Atradius Group (35.77% stake)	Germany	Grupo Catalana Occidente SA; INOC SA	Spain	537
Mar	*Ascat Seguros Generales (50% stake); Ascat Vida (50% stake)	Spain	Mapfre SA	Spain	447
Mar	Nykredit Forsikring A/S	Denmark	Gjensidige Forsikring BA	Norway	336
Jan	AK Bars Bank OAO (57.24%)	Russia	Ministry of Land & Property Relations of the Republic of Tatarstan	Russia	276
Mar	BHF Asset Servicing GmbH	Germany	The Bank of New York Mellon Corp.	USA	253
Mar	Rensburg Sheppards Plc (52.94% stake)	United Kingdom	Investec Plc	United Kingdom	249
Jan	Xafinity Group Ltd	United Kingdom	Advent International plc	United Kingdom	219
				Subtotal	5,455
				Other	2,386
				Grand total	**7,841**

Source: PricewaterhouseCoopers analysis of mergermarket, Thomsons Reuters and Dealogic data

* Mapfre entered into a JV agreement with Caixa d'estalvis de Catalunya by acquiring a 50% stake in two of its subsidiaries.

When considered together with other mid-market transactions, the 10 largest deals announced between January and March (see Figure 4) reveal several themes at work. We identify two in particular:

- **Further restructuring in banking**
  Several of the larger deals announced during the quarter reflect the ongoing impact of the financial crisis on European banking. Royal Bank of Scotland's divestment of part of its interest in RBS Sempra Commodities to JP Morgan Chase was one of the quarter's largest deals (€1,235m), although it is interesting to note that reportedly, JP Morgan had originally considered buying the whole of that business.[4] It was rumoured at the time that the announcement by US President, Barack Obama, of the so-called Volcker rule may have affected the sale process,[4] although this was never confirmed.

  The quarter's largest announced deal was BGL BNP Paribas' acquisition of a 47% stake in BNP Paribas Luxembourg for €1,339m. This was more an internal restructuring transaction than a new strategic deal, although it did involve third-party shareholders. It formed part of a package of transactions aimed at integrating former Fortis businesses in France, Switzerland, the UK and elsewhere in Europe into the BNP Paribas group.

  Other transactions also provided a reminder that governments remain significant shareholders of European banks. The Russian Republic of Tatarstan took a controlling stake in Ak Bars Bank for €276m; in contrast, FHB Mortgage Bank of Hungary took the opportunity to buy back €111m of special dividend preference shares previously issued to the Hungarian government.

- **Stronger private equity activity**
  As predicted in the February edition of this paper, financial services deals involving private equity firms increased during the quarter. Notable transactions included: Advent's acquisition of pension administrator Xafinity from Duke Street for €219m; Egeria's purchase of Aegon's Dutch funeral insurance business for €212m; Penta's support for an MBO of esure (€212m); Corsair's acquisition of Torus Insurance for €136m, and the sale of WestLB's Polish activities to local firm Abris for €64m.

  Private equity firms were, however, not only active as bidders. One of the quarter's largest deals saw UK firm Pantheon Ventures acquired from one US investment manager by another, for a price of €564m. Two smaller transactions in France saw Alstom take full control of Aster Capital for €70m and Groupe IDI acquire local rival AGF for €30m. These deals underline the apparent recovery in confidence among private equity firms. They also stand in contrast to Candover's failure to attract a buyer for its listed investment trust in 2009, after the firm had heavily written down several of its investments.[5]

In addition to these themes, we also note the recurrence of scale-building activity in several subsectors of the financial services industry. Three of the quarter's largest deals involved insurance targets, namely Catalana's acquisition of Atradius (€537m), Mapfre's joint venture purchase of 50% of Ascat Seguros and Ascat Vida from Caixa d'estalvis de Catalunya (€447m), and Gjensidige's acquisition of Nykredit (€336m). There were also signs of continuing consolidation in asset management, such as Investec's acquisition of the remainder of Rensburg Sheppards for €249m and Aberdeen's purchase of part of RBS Asset Management for €94m. Finally, in the area of financial infrastructure BNY Mellon purchased BHF Asset Servicing for €253m and BNP Paribas acquired Banca Popolare di Milano's custody business for €55m.

On the block: Loan portfolio transactions

Sales of loan portfolios are not included in our dataset, which is restricted to transactions involving equity interests. Nonetheless, it is worth highlighting some portfolio sales announced during the quarter. Graham Martin, Leader of PwC's UK Portfolio Advisory Group, looks at some of the recent activity and emerging opportunities.

- Most notable were the Irish National Asset Management Agency's acquisitions of real estate loans, aimed at improving Irish banks' ability to advance credit. Largest was an €800m transaction with Anglo Irish Bank, followed by deals with Allied Irish Banks (€263m) and Bank of Ireland (€154m) and smaller deals with the Irish Nationwide and EBS building society.
- The UK saw two private sector loan portfolio transactions: Close Brothers' purchase of GMAC's UK invoice financing book (€109m) and CitiFinancial Europe's sale of its UK card portfolio to SAV Credit (€74m).

In theory, several European markets where real estate and personal lending bubbles have burst – such as the UK, Ireland, Spain and Greece – could have the potential for further loan portfolio sales. So far, however, it has not been easy for buyers and sellers to overcome price expectation gaps and the practical hurdles of valuing these assets.

4 'JP Morgan strikes $1.7 billion deal to buy RBS Sempra units', Thomson Reuters, 16.02.10

5 'Candover ends bid talks', Thomson Reuters, 29.06.09

Stirring giant:

M&A opportunities in the German banking sector

Already ripe for consolidation, EU competition rules and the divestment of non-core and non-performing assets are giving the German merger market a renewed boost. What are the opportunities in the country's hugely valuable but crowded banking sector and who are the sellers and likely buyers?

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From Deutsche Bank's Twin Tower headquarters (known locally as 'Soll und Haben' or 'Debit and Credit'), which dominates the Frankfurt skyline, to a network of more than 400 often tiny but always proud local savings banks, the German banking sector still holds many distinctive characteristics (see box below).

What many see as the fragmentation and overcrowding in the sector has provided a strong spur for consolidation in recent years (see Figure 1). Examples at the top end of the market include Commerzbank's takeover of Dresdner Bank and Deutsche Bank's acquisition of a 30% stake in Postbank.

As the largest economy in Europe with a huge demand for banking products, foreign investors have also been looking to enter and cement their place in the market, though the multiplicity of banks and resulting competition mean that margins are generally slim.[6] The acquisitions of HypoVereinsbank (HVB) by Italian banking group UniCredit in 2005 and Citibank Deutschland (now Targobank) by French banking group Credit Mutuel in 2008 are examples of this foreign interest (see Figure 1).

More recently, the impact of the financial crisis has meant that the M&A market has been dominated by rescue operations, including the sale of SachsenLB to LBBW in 2007[7] and the acquisition of a majority stake in Hypo Real Estate (HRE) by the German government.[8] Liquidity and bad debt problems have also forced a number of institutions to seek assistance from the Government-backed 'Special Fund for Financial Markets Stabilisation' (SoFFin).

M&A resurgence

As the sector continues to stabilise in 2010, the government support from SoFFin could provide the catalyst for a resurgence in the consolidation and foreign interest seen prior to the crisis. To avoid competitive distortions, the European Commission is insisting that banks that have received state aid, sell some of their assets. Examples include LBBW,[9] Commerzbank[10] and BayernLB, which will need to divest a number of non-core activities in Germany and elsewhere in line with requirements to substantially reduce their balance sheets (LBBW by 40%, Commerzbank by 45% and BayernLB by a percentage to be announced[11]). Many of the institutions that have not received government support may also look to restructure their businesses and strengthen their balance sheets through the sale of non-core operations, further increasing the potential acquisition targets in the banking market.

6 International Monetary Fund (2009 estimates)
7 Bloomberg, 26.08.07
8 Thomson Reuters 13.10.09
9 European Commission media release, 15.12.09
10 European Commission media release, 07.05.09
11 European Commission media release, 18.12.08

Overview – A distinctive banking sector

Germany has more than 2,000 banks. The sector's relative fragmentation is reflected in the fact that the top five institutions account for only 22% of total assets, as compared to more than 80% in the UK, for example. Its overcrowding is reflected in intense competition and relatively low margins.

The sector is built around a three-pillar system of public sector banks (larger regional landesbanken such as Landesbank Baden-Württemberg (LBBW) and smaller local sparkassen such as the Hamburger Sparkasse), co-operative banks such as Genossenschaftsverband Bayern and private commercial banks including Deutsche Bank and Commerzbank. In contrast to other major European banking sectors, the public sector banks have a relatively large market share of 49%, followed by the private banking sector with 37% and the co-operative sector with 14%.

Source: 'Banking business in Germany – An overview', 2nd edition, revised and expanded (2007) and 'Bundesbank Monthly Report – Statistical Supplement' (February 2010)

Figure 1: Selected deals in the German banking sector 2005–2010

Target		Bidder		Year	Deal value (€bn)
Berenberg Bank (25% stake)	DE	Berenberg Family	DE	2010	n.a.
Sal. Oppenheim	DE	Deutsche Bank	DE	2009	1.3
Weberbank	DE	Mittelbrandenburgische Sparkasse	DE	2009	n.a.
Reuschel & Co	DE	Conrad Hinrich Donner	DE	2009	n.a.
IKB (91% stake)	DE	Lone Star Funds	US	2008	0.3
Postbank (30% stake)	DE	Deutsche Bank	DE	2008	2.8
Dresdner Bank	DE	Commerzbank	DE	2008	5.1
Citibank Deutschland	DE	Credit Mutuel	FR	2008	5.2
SachsenLB	DE	LBBW	DE	2007	0.3
LBB (81% stake)	DE	DSGV	DE	2007	4.5
HVB	DE	UniCredit	IT	2005	15.4

Source: PricewaterhouseCoopers research and mergermarket

N.A. = not available

Figure 2: Current and future targets in the German banking sector

Company Name	Completion deadline	Balance Sheet (€m)	Equity (€m)	Financial Year	Status
Commerzbank					
Eurohypo AG	until 2014	291,600	4,022	2008	not yet sold
Allianz Dresdner Bauspar AG	until 2011	3,800	99	2008	not yet sold
LBBW					
HSBC Trinikaus & Burkhardt AG (20% stake)	not specified	22,206	955	2008	not yet sold
WestLB					
Westdeutsche Immobilienbank AG	until 2011	26,171	861	2008	in process
Readybank AG	until 2011	400	19	2008	not yet sold
Others					
Hypo Real Estate	not specified	419,700	(1,508)	2008	not yet sold
HSH Nordbank AG	not specified	208,400	2,145	2008	not yet sold

Source: Handelsblatt, 25.05.09, Annual Reports 2008, corporate websites

Figure 1 shows a selection of the assets being put up for sale, the balance sheet total (€972bn in total), equity values (€6.6bn in total) and the completion deadlines given by the European Commission. As the balance sheet equity in Figure 2 represents the lower limit of the potential sales price, most vendors are likely to get a better offer, though the time pressure to divest may curtail deal values.

We also believe there is likely to be increasing activity in Germany's non-performing loan (NPL) market. According to the Bundesbank, the nominal value of the country's NPLs was around €200bn in 2008. The central bank also estimates that there will be a further €90 billion of write-downs in 2010 (the equivalent of around a quarter of the aggregate shareholder equity in the German banking sector), consisting of €15 billion in distressed assets and up to €75 billion in loan loss provisions.[12] In 2009, several major German banks transferred their NPL portfolios into internal restructuring units, though as such they remain on their balance sheets. Offloading these portfolios would enable them to free up regulatory capital for new lending, which is likely to fuel growing supply side interest in pursuing NPL transactions in 2010.[13]

12 Deutsche Bundesbank – Financial Stability Review (November 2009) and Monthly Report (March 2010)
13 PwC NPL Europe – Market Update 2009 for Germany

Stirring giant: M&A opportunities in the German banking sector

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Potential buyers

The question remains: Who will want to acquire these non-core and non-performing assets? There are three groups of potential buyers: domestic financial institutions, foreign financial institutions and private equity funds, though all will need to weigh up a number of pros and cons.

German institutions may see this as an opportunity to strengthen their market position in their home market, especially as many are looking to re-focus on their core domestic business in the wake of the financial crisis. However, as most of the larger German banks have received state aid and therefore have to divest some of their own subsidiaries, this only leaves a few domestic banks (e.g. Deutsche Bank, Helaba, Landesbank Berlin, Unicredit/HVB) that are able to invest. Due to relatively low sales prices, some of these banks have already completed transactions (e.g. Deutsche Bank's acquisition of Sal. Oppenheim[14]) or are currently planning to invest (e.g. a potential bid by Unicredit/HVB for SEB's German retail operations[15]).

Some of the larger international financial services groups came through the crisis relatively unscathed and now have excess capital that they are willing to invest. Targets might include German banking operations. As we have outlined, however, margins are relatively tight. In addition, a number of foreign institutions such as Citibank[16] have gone the other way by selling their German businesses. Potential buyers are therefore likely to be highly selective and apply exceptional scrutiny before committing to a deal. As in the past, foreign investment banks could also participate in future NPL transactions.

The third group of potential investors are private equity funds, especially as bank funding is likely to improve in 2010. According to PricewaterhouseCoopers' latest private equity trend report, more than three-quarters of German private equity funds are optimistic about their prospects in 2010 and expect M&A across all sectors to pick up momentum during the course of the year.[17] However, private equity interest in financial services may be tentative at this stage. Although 45% of German funds anticipate that opportunities will arise from the disposal of equity stakes by banks, only 3% of German funds and 17% of international funds are currently reported as focusing their attention on the financial services sector.[18] However, some private equity funds have been mentioned as potential bidders in the current sales process of Westdeutsche Immobilienbank (WestImmo), a real estate financing subsidiary of WestLB.[18] Alongside foreign investment banks, private equity funds have also been among the main buyers of NPL portfolios in recent years and are therefore likely to look with interest at the current opportunities.[19]

Timing

If the price fits the vendor's expectations, deals on the best potential targets and portfolios could be closed fairly quickly. Others, especially the mortgage and real estate banks (e.g. Eurohypo and HRE) will need to be restructured prior to sale, which may take at least two years.

As a result of the financial crisis many banks will have to reconsider their business models. This applies in particular to the state-owned landesbanken, where political pressure for consolidation is growing. Among the companies thought to be considering mergers are BayernLB and LBBW.[20] If these deals go ahead, they could accelerate the momentum of M&A by forcing rivals to follow suit in order to keep up with the strength of their newly merged competitors.

Gathering momentum

An over-banked and over-branched sector heightens competition and erodes margins, making the sector ripe for consolidation. EU competition rulings and growing political pressure from within the country are adding further impetus to the resurgence of M&A. The returns may take some time to materialise. However, this is a huge banking market that offers opportunities for synergies and market development that few other countries of this size and wealth can match.

Editorial eye

Many market participants and observers have long expected the German banking market to consolidate. Although restructuring is almost inevitable, the timing has been uncertain. With strong domestic political pressure in the wake of the global economic crisis and the EU competition rulings, consolidation may now finally get under way. This ought to present a number of attractive opportunities for both domestic and patient foreign banks.

14 Deutsche Bank media releease, 15.03.10
15 Thomson Reuters, 22.04.10
16 Thomson Reuters, 11.07.08
17 'Navigating the rocky road to recovery, PricewaterhouseCoopers Private Equity Trends' 2010
18 Thomson Reuters, 16.04.10
19 Property Funds World, 10.12.09
20 Forbes magazine, 21.11.08

Market shakeout:

Restructuring creates openings in Spain

Rationalisation and divestment in the Spanish financial services sector is opening up acquisition opportunities for competitors and new entrants.

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With more than €300bn of lending to developers (nearly €30bn more than the total equity in the Spanish banking sector and some 10% of its total assets),[21] Spain's property crash has left the country's banks with a huge weight of bad debts (see box). Despite the positive impact of interest rate reductions in 2009, high impairment levels will continue to hold back financial returns in the short to medium term. Banks are therefore striving to cut costs and improve process efficiency. Deal activity, both among institutions receiving government support and elsewhere, is also likely to increase as organisations look to rationalise their holdings, strengthen their balance sheets and capitalise on potential synergies.

A key focus of deal activity will be among institutions receiving support from the government-run Fondo de Reestructuración Ordenada Bancaria (FROB). The FROB is principally aimed at the cajas (savings banks). In return for funding (mainly through the purchase of preference shares), institutions will be encouraged to merge. Others will be required to integrate their operations as part of a Sistema Integrado de Protección (SIP – contractual groupings, which maintain the legal identity of each of the cajas). The benefits of consolidation and integration will be improved efficiency, renewed access to the capital markets and a reduction of excess capacity in the banking system.

Further anticipated deal activity can be divided into six main areas:

Industrial holdings

A number of leading banks are divesting their non-financial interests. Santander relinquished its last significant industrial holding with the sale of Cepsa in 2009.[22] Following the sale of stakes in Iberdrola, Repsol and Iberia, BBVA's only significant non-financial interest is its stake in Telefonica.[23] On the other side of the coin, La Caixa and Caja Madrid still maintain significant industrial holdings. It is not certain what route the remainder of the cajas will follow. What is clear is that the sale of these holdings can help to simplify management and improve liquidity and/or capital. Although the financial benefits may be affected by unrecognised losses in some entities, there are many other cases where investments represent latent gains. There are also a significant number of potential investors willing to structure deals in a way that takes best account of the vendors' interests.

> ## Long road: Spain's financial crisis
>
> The initial phase of the financial crisis tended to be less traumatic in Spain than many other developed economies. Spanish banks had focused on more traditional business and therefore had lower exposures to sub-prime securitisations and other such structured products. They also had the benefit of high capital ratios and countercyclical provisions.* However, with more than €300bn of lending to developers, Spanish banks have felt the full force of the country's property crash. With the near 20% unemployment fuelling a continuing increase in payment difficulties and bad debts, we believe the impact of the crisis will be longer lasting than many other countries.
>
> * Since 2000, Spanish banks have been required to build up a credit buffer during periods of high growth and low default to cover for downturns, which is based on a comparison between current impairment rates and a prescriptive formula defined in Spanish banking regulations.

21 'Spanish banks postpone losses, store up trouble', Thomson Reuters, 10.03.10/Banco de España Boletin Estadistico (March 2010)

22 Santander media release, 31.03.09

23 BBVA owns around 5.5% of the shares in Telefónica, a global telecommunications company with a market capitalisation of some €73bn at the beginning of May 2010 (Telefónica Financial Statement 31.12.09 and listed prices)

Market shakeout: Restructuring creates openings in Spain
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Distressed assets

Many international investors are keen to acquire portfolios of distressed assets, such as books of defaulted loans. As loans now require greater provisioning levels, which has led to a reduction in the book values of assets, it is likely that this market will start to pick up. There have also been some indications that the price expectations of vendors and investors have moved closer in recent months. Such transactions could offer good returns for investors. For banks and cajas they could help to simplify management, generate liquidity and free up regulatory capital for new lending.

Non-core assets

Some groups may be keen to rein in their expansion plans in the wake of the crisis. One area is branch networks, with a number of banks looking to either close branches and transfer customers to other branches or alternatively sell unwanted branches to another player. Among those that have or are planning to sell and lease back branches are BBVA[24] and Sabadell.[25] In turn, banks that have announced their interest in acquiring branch networks from other institutions include Banco Popular.[26] The Bank of Spain has also opened up an opportunity to acquire savings bank assets through the precedent of Caja Castilla La Mancha (CCM), which was bailed out with a guarantee of €9bn in March 2009 and sold to Cajastur in November 2009.[27]

Bancassurance

Bancassurance is the primary distribution route for life insurance in Spain and an important channel for non-life cover. Exclusive distribution agreements have been signed by many firms and will need to be reviewed following any mergers or SIPs. With some institutions yet to sign agreements, there is likely be an increase in the number of deals, once the current uncertainty surrounding sector consolidation begins to lift. Recent announcements include

24 BBVA media release, 25.09.09
25 Estates Gazette, 13.03.10
26 Thomson Reuters, 24.11.09
27 Wall Street Journal, 30.03.09/El Pais, 04.11.09

Mapfre's acquisition of a 50% stake in the insurance units of Caixa Catalunya, Ascat Vida and Ascat Seguros, which will provide Mapfre with a valuable opportunity to boost distribution[28] and considerable capital benefits for the seller. In addition to the €447 million raised through the sale,[29] the deal will increase Caixa Catalunya's solvency ratio by 0.70% and improve its core capital ratio by 0.60%.[30]

Asset management

Consolidation in the asset management sector was already well under way prior to the crisis and is likely to pick up once again as the economy improves. Spain's 'big four' (BBVA, Santander, La Caixa and Caja Madrid) have a combined market share of more than 50% of assets under management.[31] Continuing reductions in commission levels in lower value-added products make market share an important factor, enabling institutions to take advantage of economies of scale and develop the critical mass to be able to invest in the development of more specialised products. There appears to be strong demand among buyers, with many looking to increase scale and take advantage of future share price gains. While the sale of asset management subsidiaries will result in the loss of future commission flows, it enables sellers to generate potentially significant one off gains and thereby strengthen capital.

Cross-border opportunities

Santander has already invested around $40bn in the Americas and has 5,700 branches and 856,000 employees in the continent.[32] BBVA has invested around $25bn and has 61,000 employees in Latin America.[33] Mapfre is the largest international insurer in Latin America, with a workforce of 10,500.[34] The restructuring of financial services worldwide is creating further opportunities in a number of markets. Two clear examples are the US and the UK, given the number of entities under the control of the Federal Deposit Insurance Corporation and the level of assets under UK government control. Both Santander and BBVA have recently expressed interest in the sale of branches by RBS[35] (the first edition of M&A Insight includes an article focusing on inward investment opportunities in UK banking).

Back to basics

In common with a number of other countries, Spain is entering into a phase that will be characterised, with certain limited exceptions, by a 'back to basics' approach. This rationalisation and retrenchment by the segments of the market most affected by the economic crisis is opening up some excellent opportunities for investment, while providing a welcome boost to the financial position of the divesting companies.

Whatever the capital position and P&L shape of a financial services company, the current environment demands absolute clarity around strategic options, not just in relation to mergers, integrations and cost reduction, but also in relation to potential divestments or acquisitions of assets. Given the state of the market, the role of high-quality due diligence and valuation in this process is more important than ever. This is no time to jump in at the deep end!

Editorial eye

Spain's economy has been one of the worst hit in Western Europe and the property crash will almost certainly mean that recovery will be slow. There are likely to be opportunities for foreign acquirers to buy companies and assets in their domestic markets from Spanish financial services institutions that have expanded geographically over the last 10 to 15 years and for the longer term strategic acquirer to buy into – or continue to expand in – the Spanish market, particularly in the short-term, while domestic competition may be weak.

28 Caixa Catalunya and Mapfre joint media release, 05.03.10
29 Caixa Catalunya and Mapfre joint media release, 05.03.10
30 Expansion, 09.03.10
31 Global Pensions, 14.01.10
32 Santander Annual Report 2009
33 BBVA Annual Report 2009
34 Mapfre Annual Report 2009
35 Wall Street Journal, 08.04.10

Looking Ahead

Deal activity should begin to accelerate

Although financial services M&A activity in Europe remains subdued, the processes of restructuring and consolidation continue to shape parts of the industry. As mentioned in the February edition of this paper, we believe that M&A volumes will experience a recovery during the year, and feel that recent deals give some insights into the shape of future activity.

The most obvious driver of M&A activity is the ongoing restructuring of European banking. First, banks that have retained all or most of their independence will continue to rationalise their non-core activities. Second, those that have maintained or rebuilt their regulatory capital ratios – whether from Europe or outside – will seek to capitalise on competitors' weaknesses. Third, banks that have acquired distressed targets will continue to integrate their purchases, possibly generating further peripheral divestments.

The coming months are also likely to see a number of transactions involving publicly controlled banks. Royal Bank of Scotland may have sold part of its interest in RBS Sempra Commodities (see 'Data Analysis'), but in common with other recipients of government support such as Lloyds Banking Group, ING, KBC and Commerzbank, it still has some way to go to satisfy European Commission State Aid conditions.

In the UK, the outcome of the general election could also have an effect on financial services deal activity. The government is likely to be keen to announce the sell-off of at least part of the UK government's stake in Northern Rock, RBS or Lloyds Banking Group, although we continue to believe that large-scale exits are unlikely in the short term.

Beyond banking, we expect to see further scale-building transactions during the coming months among insurers, financial infrastructure companies and asset managers. Some of this activity will be stimulated by banks' disposals. Even so, many banking groups will still prefer to hold on to subsidiaries if they provide positive operating cash flows or, in the case of more diversified financial institutions, a potential regulatory capital advantage.

Consolidation in asset management could receive an additional boost from forthcoming regulatory changes. In particular, the incoming UCITS IV directive has the potential to simplify the European industry's complex structure by encouraging asset managers to consolidate their operations. Service providers may also seek to expand their footprint across Europe. The eventual M&A impact of the Alternative Investment Fund Managers Directive is less clear, but several of the provisions currently under discussion could have material effects on the structure of the industry.

Lastly, we expect to see further M&A activity involving private equity firms. As predicted in the February edition of this paper, private equity bidders became increasingly active during the early part of 2010. The growing availability of debt finance, the recovery in financial services valuations and some funds' need to invest capital raised before the financial crisis are all stimulating activity.

Activity around pure banking and insurance targets remains modest, but payments, processing and other financial infrastructure businesses with low capital requirements are under increasing focus. This is illustrated by the strong private equity interest in the upcoming sale of RBS' Global Merchant Services business, including its WorldPay brand. In contrast, sales of distressed loans could remain relatively subdued, owing to the complex and often interdependent issues that affect pricing gaps between buyers and sellers.

Methodology

FS M&A Deal Activity analysis

This issue includes financial services deals:

- Reported by mergermarket, Thomson and Dealogic;
- Announced during the first quarter of 2010, and expected to complete;
- Involving the acquisition of a >30% stake (or significant stake giving effective control to the acquirer); and
- Acquisitions of Europe-based financial services targets where a deal value has been publicly disclosed.

Since 2009, our data coverage has included Dealogic information; however, comparative figures for previous years have not been restated.

Our analysis also excludes deals that, in our view, are not 'true' financial services deals, for example real estate deals and sales/purchases of asset portfolios where the disclosed deal value represents the value of assets sold.

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Are you ready to capitalise?

Deal activity in the financial services industry is likely to increase in 2010 as markets stabilise and restructuring in the sector gathers pace.

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