Sustained momentum around bank M&A in Europe

Scope Ratings

Bank M&A momentum in Europe, unleashed by the pick-up in closed and announced deals, shows no signs of slowing. Several deals are in process and there is an overhang of potential transactions. Market speculation continues to talk up the prospects of more.

Since the beginning of 2020, Refinitiv has tracked 50 deals involving European banks for almost USD 37bn of value, including stake building and clean-up stakes as well as outright mergers or acquisitions. Consolidation is predominantly happening within national borders, and this will likely remain the focus despite clear supervisory encouragement of cross-border deals and risk sharing.

We see capacity reduction as positive, especially in countries like Italy, Spain, and Germany where banking is characterised by high degrees of fragmentation and/or very dense branch networks. We expect the trend towards greater consolidation to continue in 2021 and 2022, with domestic deals taking the lion's share of activity.

In-country mergers offer second-tier banks the opportunity to leverage the benefits of scale to lessen the gaps to national champions and compete on a more level playing field. They also offer national champions an opportunity to consolidate their positions.

UniCredit's exclusive discussions with the Italian Ministry of Economy and Finance is a case in point and will see the situation of Banca Monte dei Paschi di Siena reach some form of resolution if a deal can be struck. A UniCredit/BMPS deal is not a certainty at this point, but the framework of agreed pre-requisite terms under which the discussions are being conducted appear to favour UniCredit taking over defined parts of BMPS. If concluded, the deal will add to the flow of transactions in Italy and Spain: Intesa/UBI, Credit Agricole/Creval, CaixaBank/Bankia, Unicaja/Liberbank, and Abanca/Bankoa.

The economic benefits of in-market consolidation remain very strong because the recession has enshrined the negative rates/flat yield curve outlook. This environment is highly damaging to bank revenues, and cost-cutting is the main managerial lever to protect the bottom line. The value of cost synergies is higher than before. Faced with rapid transformation of consumer and corporate preferences, priorities for most banks lie elsewhere. Post Covid, a rethink of distribution is more pressing now than at any time since the global financial crisis. Adding obsolete branch networks in new markets through M&A is not a priority.

To the extent that cross-border deals emerge, these will tend to be by large foreign players seeking to add scale in core countries through bolt-on acquisitions rather than strategic cross-mergers of equals (although clearly the latter cannot be fully discounted depending on circumstances).

Financial investors are also actively sourcing transactions. HSBC is in the process of selling its French retail banking business to Cerberus, which has been actively acquiring banks or bank stakes in Europe, including in Deutsche Bank, Commerzbank, HSH Nordbank, BAWAG and others. Apollo and J.C. Flowers are also active; both having reportedly submitted bids for Portuguese bank EuroBic, alongside domestic bidders Novo Banco and post office bank Banco CTT. Flowers and Bain Capital recently acquired BlueMountain Capital's minority roughly 10% stake in the UK's Co-Operative Bank.

Spain's Abanca is said to be keeping a close eye on the bidding as the group looks to build scale. Earlier this year, Abanca acquired the Spanish business of Portugal's Novo Banco, highlighting the potential for deals between banks in closely aligned contiguous markets. Spain's CaixaBank previously acquired Portugal's Banco BPI.

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Policymakers push for greater scale

Supervisory efforts to boost M&A by allowing badwill to count towards capital requirements have not made any material difference to-date, but EU policymakers continue to push for greater scale in European banking in the face of what they see as a threat to Europe’s financial sovereignty from bigger, better capitalised, better performing and more profitable US banks.

Strategic cross-border bank M&A offers very little incremental returns in a low-rate environment, however, and there are structural challenges: benefits are limited by the lack of cost and funding synergies due to regulatory ring-fencing and the absence of a complete Banking Union.

Overhang of expectation for transactions

There continues to be an overhang of expectation around certain banks, which could ostensibly move quickly to in-play situations. Long-run speculation about a deal involving Banco BPM refuses to go away; some still linking it with a tie-up with BPER Banca. The latter has also been linked with Banca Popolare di Sondrio as well as Banca Carige.

The prospectus detailing the re-admission of Carige shares to trading on 27 July following a 30-month suspension noted the critical importance of a merger: “Attention is drawn to a business combination, which represents a key action to be carried out to conclude the path started by the Temporary Administrators, in line with the specific mandate given to them by the ECB …”

In the UK, the CEO of Spain’s Banco de Sabadell, which owns TSB Bank, acknowledged in the media that the acquisition was a strategically bad decision, and that the group is open to offers as work continues on a turnaround programme. The fate of Sainsbury's Bank, owned by supermarket group J Sainsbury plc, is also subject to occasional speculation regarding the group’s commitment to maintaining a full-service financial services business.

And there are expectations regarding consolidation in the UK challenger and digital bank space. This has become a very crowded market with dozens of incumbents, but profitability in this segment has also been challenging. Those pointing to consolidation believe it could take the form of in-segment mergers or takeovers, or acquisitions of mobile-enabled challengers by larger banks seeking to accelerate their digital strategies.

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