PricewaterhouseCoopers

European banking consolidation

April 2006

03

Summary

- The cross-border consolidation of the European banking industry has been under way for some time with 274 transactions (€158bn) announced during the last 10 years. Key historical trends include the following:
  - The value of cross-border bank M&A has been rising for the last three years while the value of domestic bank M&A has been falling since 1999.
  - Seventy-two percent of M&A activity (by value) has focused on the acquisition of controlling stakes. After peaking in 1999, transactions involving the acquisition of minority stakes have been in decline.
  - Eighty-three percent (by value) of European cross-border bank M&A involved western European banks acquiring stakes in other western European banks with the top 10 deals accounting for almost half (by value) of all European cross-border bank M&A during the last 10 years.
  - European banks spent €27bn on 89 deals, acquiring stakes in banks in the faster growing economies of 'emerging' Europe.
  - The value of European cross-border bank deals announced in 2005 exceeded the last peak in M&A activity in 2000.

- There is a clear polarisation in the geographic focus of the cross-border M&A strategies of Europe's most acquisitive banks. Measured by value of cross-border bank M&A activity, European banks have tended to focus either predominately on Europe or on M&A targets outside of Europe.

- Four major bank M&A transactions have been announced in the last two years. Is this the beginning of a trend?

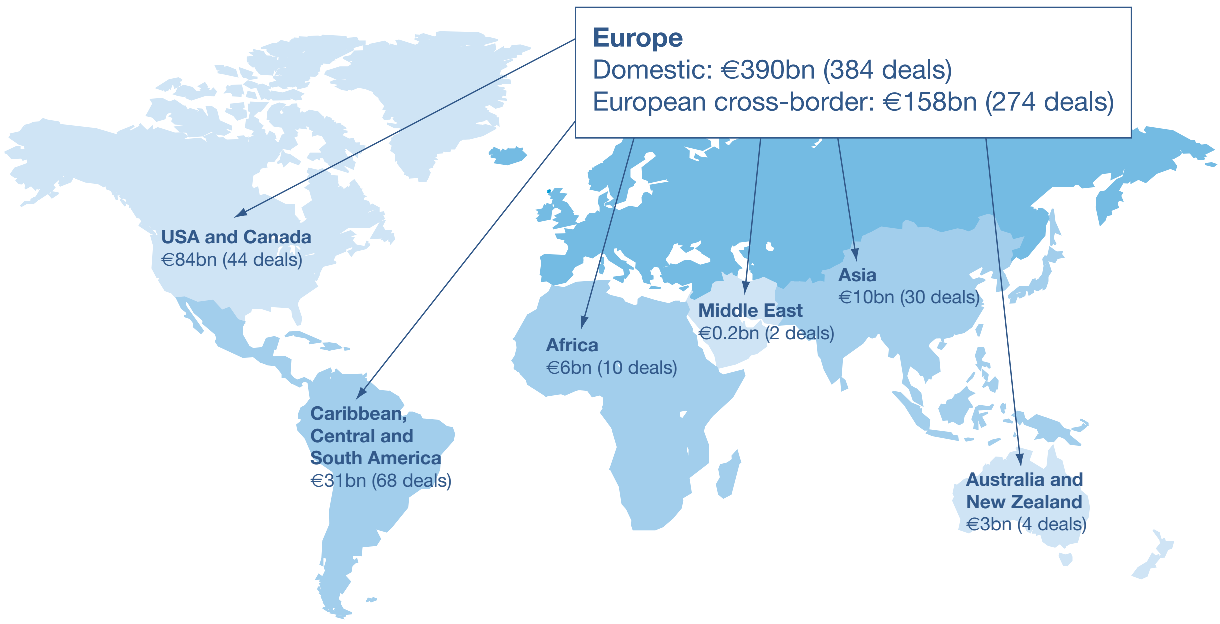
- Assuming the current high levels of CEO confidence can be maintained, we believe that there are a number of reasons why cross-border bank M&A activity in Europe is likely to increase over the next two or three years:
  - Domestic consolidation opportunities may be limited in certain markets due to existing concentration giving rise to competition restrictions or due to the lack of available sizeable targets.
  - Appetite for exposure to higher growth markets is expected to increase the level of M&A activity in 'emerging' Europe, in particular in the less mature Commonwealth of Independent States (CIS) markets.
  - European banks are projected to generate substantial surplus capital over the next few years.
  - A number of European banks have indicated their willingness to engage in cross-border deals just as the impediments to such M&A activity are being challenged by the European Commission (EC).

Introduction

In the period between 1 January 1996 and 31 December 2005 European banks spent €682bn (816 deals) acquiring banking businesses throughout the world. As is reflected in Figure 1, cross-border consolidation within Europe accounted for one-third of this activity (measured by the number of M&A deals).

In this paper, after briefly considering where European banks have been undertaking bank M&A activity, we comment on the outlook for European banking consolidation. This is supported by analysis and commentary on cross-border bank consolidation within Europe during the last 10 years, based on an analysis of deals announced between 1 January 1996 and 31 December 2005.

Figure 1: European banks' M&A activity 1996-2005 analysed by location of target



Source: PricewaterhouseCoopers analysis of Dealogic data

Methodology

A data set of M&A deals involving European banks was obtained from a Dealogic database and then 'cleansed' to remove deals where the target or bidder was not a 'banking' business (e.g. the business was an insurance operation, asset management operation, etc.), the deal value was not disclosed or was less than €50m, the deal involved either the acquisition of an asset portfolio or the deal was not an M&A transaction (e.g. acquisition of shares by investment funds).

Our analysis is based on 816 banking deals (total value €682bn) identified post the 'cleansing' exercise (the original Dealogic data set included c. 5,000 deals with a total value of c. €1,000bn).

Europe’s most acquisitive banks

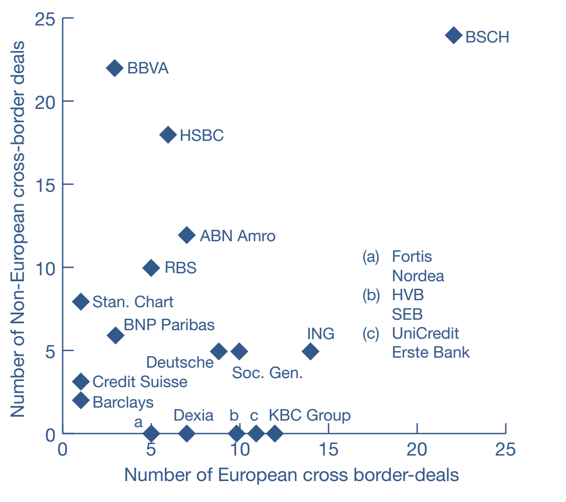
Figure 2 shows that Europe’s 20 most acquisitive banks (ranked by the value of cross-border M&A activity over the last 10 years) have made a significant number of cross-border investments both within and outside Europe.

However, analysis of the same activity by value (see Figure 3), shows a clear polarisation of cross-border M&A strategies. For example, Nordea’s and Unicredit’s cross-border M&A activity has focused almost exclusively on European deals, while Credit Suisse and RBS’s cross-border M&A activity largely involved non-European deals.

ABN Amro, BSCH and HSBC stand out in that they have engaged in significant cross-border M&A, both in Europe and elsewhere.

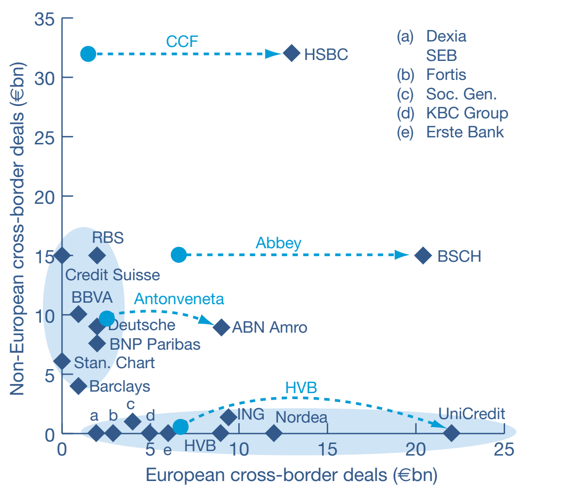
A number of Europe’s largest banks (measured by market capitalisation), for example, Banca Intesa, Credit Agricole, HBOS and Lloyds TSB are notable for their absence, owing to their relatively low investment in cross-border M&A over the last 10 years.

Figure 2: Number of cross-border bank M&A deals undertaken by Europe’s most acquisitive banks (ranked by value of M&A activity) 1996-2005[1]



Source: PricewaterhouseCoopers analysis of Dealogic data

Figure 3: Value of cross-border bank M&A deals undertaken by Europe’s most acquisitive banks (ranked by value of M&A activity) 1996-2005[1]



Source: PricewaterhouseCoopers analysis of Dealogic data

Note:

1) The deal data analysed in this document was extracted from a Dealogic database on 3 January 2006 and ‘cleansed’, as described on page 3. While we have attempted to validate the completeness of the ‘cleansed’ Dealogic data by comparing it to Mergermarket information, there is still the possibility that the databases used may not have captured every single bank merger or acquisition over the last 10 years.

2) HVB is included in Figures 1 and 2 because it was one of the top 20 most acquisitive banks over the last 10 years (HVB was acquired by Unicredit in 2005).

3) The above analyses include only those deals where the target is a banking business (e.g. portfolio acquisitions and ‘non-banking’ targets have been excluded).

4) For purposes of the above analysis, where two institutions have merged (e.g. Banco Santander and Banco Central Hispanoamericano), our analysis only considers the transactions undertaken by the bidder pre-merger (as defined by Dealogic) and the merged entity post-merger (i.e. deals undertaken by the target prior to being acquired are excluded from the above).

5) Fortis has a unique parent structure with ‘twinned’ holding companies in Belgium and the Netherlands: six deals with a total value of €15bn undertaken by Fortis in Belgium and the Netherlands have been reflected as domestic deals for the purposes of this paper.

Outlook for European banking consolidation

Interestingly, over the last two years, four European banks – ABN Amro, BNP Paribas, BSCH and Unicredit – have made major acquisitions in Europe. Is this the beginning of a broader trend?

These transactions may or may not signal the beginning of a major consolidation wave. Nevertheless, there are a number of reasons why cross-border M&A activity in Europe may increase over the next two to three years:

- The larger players in a number of territories are unlikely to grow through further domestic M&A because their domestic markets have become increasingly concentrated. The degree of concentration (measured in terms of the percentage of total banking assets held by the five largest banks in each market) in western Europe's banking markets ranges from in excess of 80% in the Netherlands to 22% in Germany.

- Notwithstanding the above, during early 2006 there have been a number of actual and potential deals discussed in the financial press (e.g. Millennium BCP's bid for Banco BPI in Portugal and Caisse d'Epargne's potential merger with Banque Populaire in France), which indicate that further domestic consolidation may follow as a reaction to the increase in cross-border consolidation.

- While foreign ownership of banks in CEE is high and fewer privatisation opportunities remain, consolidation among privately held banks may follow, as these markets develop. Other markets are, however, opening up in the CIS where M&A opportunities exist among the private and state-owned banks.

- Although they differ on the quantum, there is a view among bank analysts that European banks will generate significant excess capital in the next few years. At least part of this capital is likely to be used to fund growth through M&A activity.

- The EC has for some time been focused on the removal of impediments to European cross-border banking consolidation. In this regard, the EC in its White Paper on Financial Services Policy (2005-2010) has stated that its principal objectives over the next five years include:

"[To] consolidate dynamically towards an integrated, open, inclusive, competitive, and economically efficient EU financial market;"

"[To] remove the remaining economically significant barriers so financial services can be provided and capital can circulate freely throughout the EU at the lowest possible cost…"

• Press comment suggests that European banks are actively pursuing cross-border opportunities in Europe:

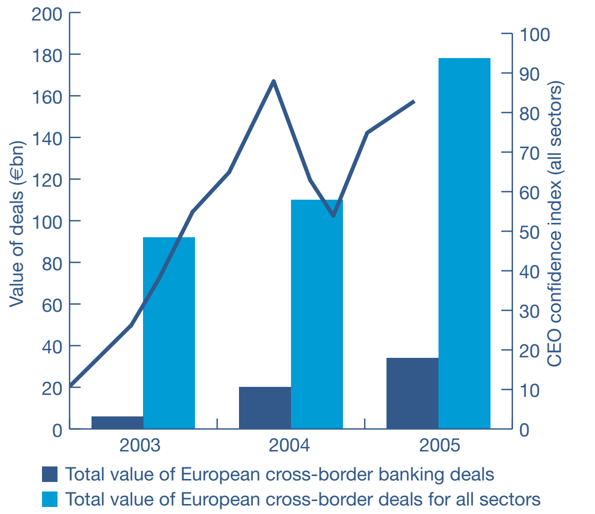
> "A spokesman for Deutsche Bank… said that the bank wanted to enter interesting growth markets and Eastern Europe is an area where it is looking for market opportunities"
>
> South East Europe Newswire 25 November 2005

> "Georges Pauget, Credit Agricole's chief executive… told the Financial Times last week that he would spend Euros 5 billion on acquisitions outside France by 2008. The main targets were retail banking assets in Europe, with a view to reducing the reliance on France…"
>
> Financial Times 14 December 2005

> "The chief executive of BNP Paribas said yesterday that the French bank had been forced into launching a surprise €9bn ($10.8bn) bid for Italy's Banca Nazionale del Lavoro to respond to growing consolidation in Europe's banking sector.
>
> Baudouin Prot said: 'Consolidation had definitely started'."
>
> Financial Times 6 February 2006

Over the last three to four years we have witnessed an increase in CEO confidence, which is in our view an important driver of M&A activity. It will be interesting to see how the level of confidence of CEOs develops and how this impacts on the trend in European cross-border banking consolidation.

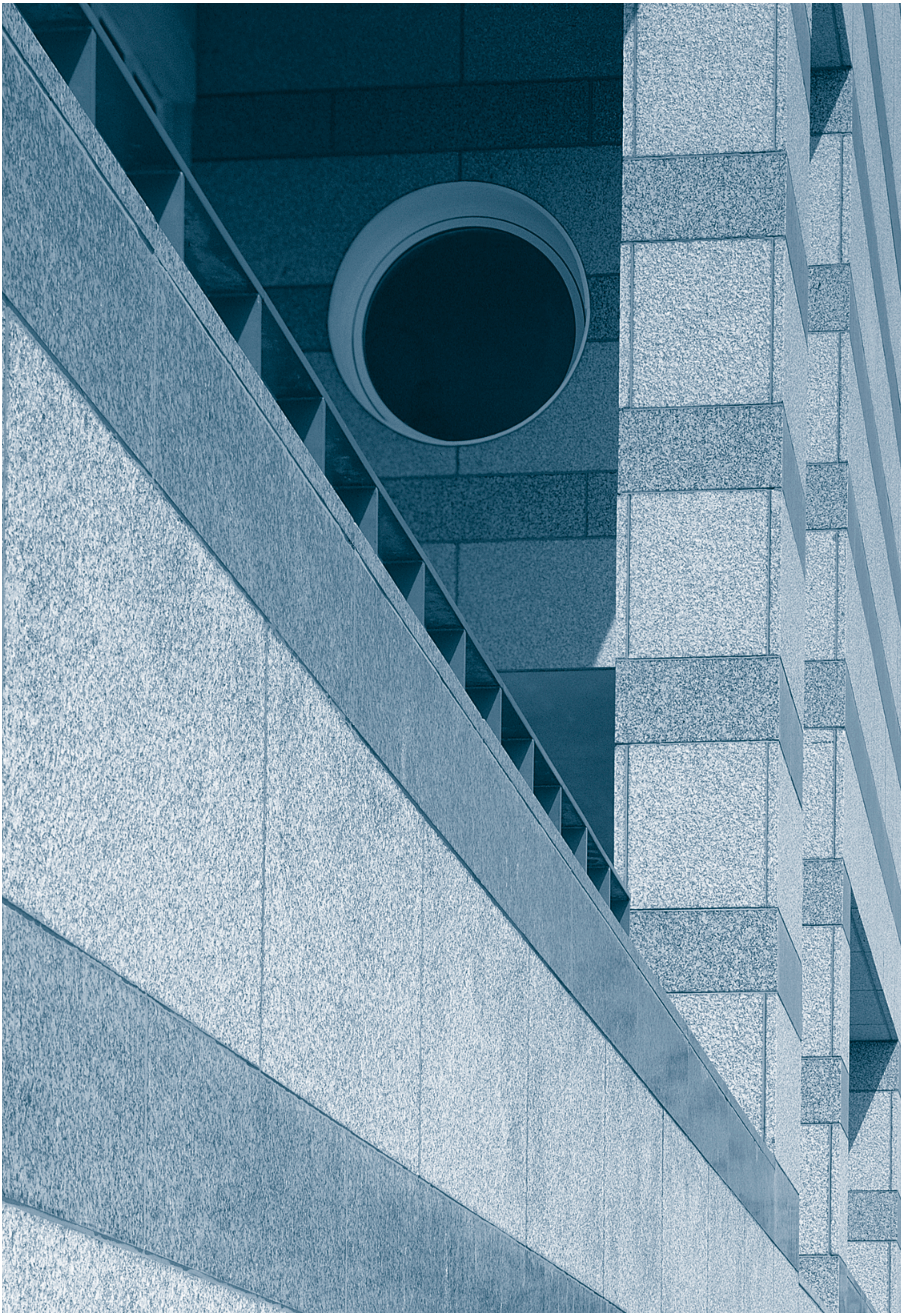
Figure 4: CEO confidence and total European cross-border M&A activity (2002-2005)



Note: *Goldman Sachs CEO Confidence Index (Capital Investment in International M&A-Europe) from June 2002 to February 2005 (the last published information). 50 represents an equal balance between those who think confidence is improving and those who think it is worsening.

Source: PricewaterhouseCoopers analysis of Dealogic and Goldman Sachs data

There are a number of reasons to believe that cross-border banking consolidation will increase in Europe during the coming years. Ultimately, however, whether or not significant cross-border deal activity emerges over the next two to three years will, in our view, depend largely on whether current levels of CEO confidence and macroeconomic stability remain in place.



Key trends: Domestic M&A and cross-border M&A

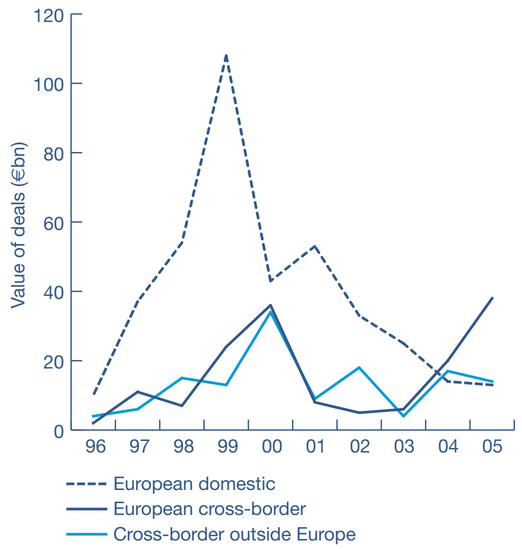
Our analysis of M&A activities of European banks (Figure 5) shows that, after peaking in 1999, the value of European domestic banking deals has been in decline and, for reasons that have been widely commented on in the financial press (e.g. concentration of assets and the competition concerns of regulators), are not expected to immediately, if ever, recover to previous levels. Many European banks looking to grow through acquisition are increasingly needing to look outside their domestic markets for suitable banks to acquire.

As discussed on page 4, European banks have entered into cross-border bank M&A deals both within and outside of Europe. Interestingly, our analysis (Figure 5) shows that during the period 1996 to 2004, the value of cross-border bank M&A deals outside of Europe has closely mirrored that within Europe. This trend was deviated from in 2005, where the multi billion euro HVB and Antonveneta deals contributed to the value of European cross-border bank M&A deals, being c. 2.7 times that of non-European deals.

The value of European cross-border bank M&A deals reached record levels in 2005

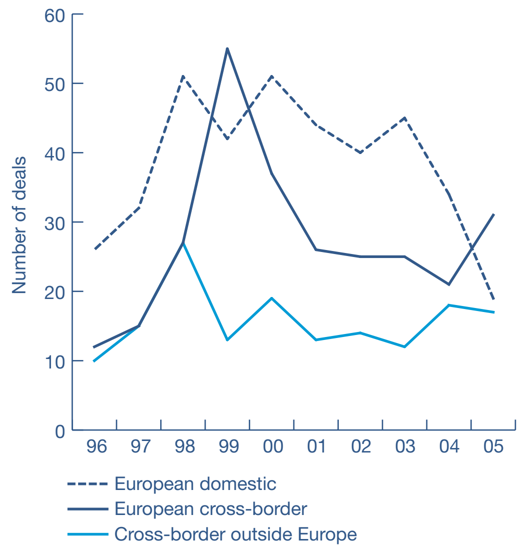
Our analysis also suggests that cross-border consolidation of the European banking industry has been under way for some time: in the last 10 years, European banks have spent €158bn on 274 cross-border M&A deals, involving other European banks (for example, HSBC's acquisition of Credit Commercial de France, Barclays' acquisition of Banco Zaragozano and Unicredit's acquisition of HVB).

Figure 5: Value of European banks' bank M&A activity 1996-2005



Source: PricewaterhouseCoopers analysis of Dealogic data

Figure 6: Number of bank M&A deals undertaken by European banks 1996-2005



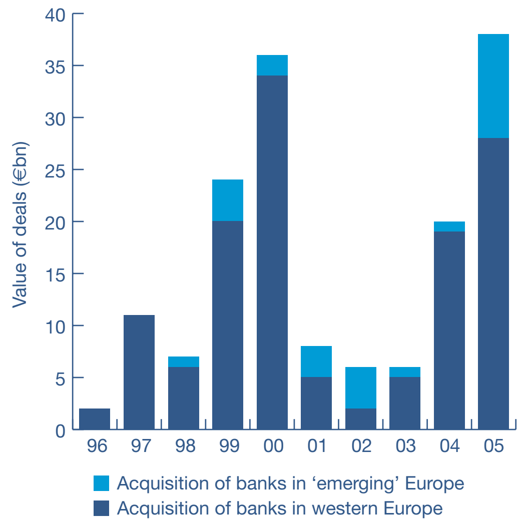
Source: PricewaterhouseCoopers analysis of Dealogic data

Key trends: western and emerging Europe

Approximately 83% of the value of bank M&A deals in Europe involved the acquisition of stakes in western European banks.

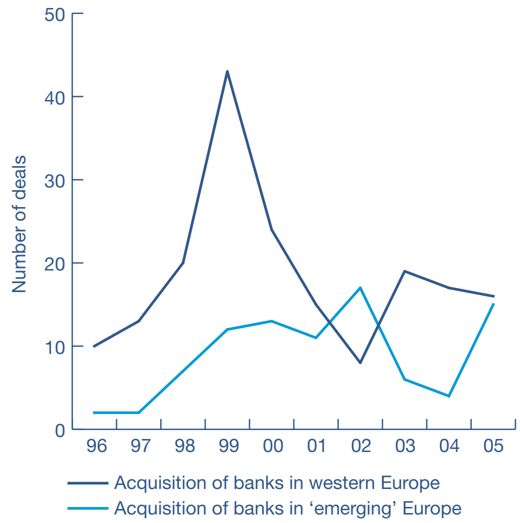
However, approximately one-third of the number of bank M&A deals in Europe over the last 10 years have involved banks in western Europe acquiring all or part of banks in 'emerging' Europe (collectively, central and eastern Europe (CEE), the Commonwealth of Independent States (CIS), the Baltic States and Turkey).

Figure 7: Value of European banks' cross-border bank M&A activity in western and 'emerging' Europe 1996-2005



Source: PricewaterhouseCoopers analysis of Dealogic data

Figure 8: Number of cross-border bank M&A deals undertaken by European banks in western and 'emerging' Europe 1996-2005



Source: PricewaterhouseCoopers analysis of Dealogic data

Consolidation among banks in western Europe

Figure 9: Top 10 announced cross-border bank deals in western Europe (1996-2005)

No.	Deal value (€m)	Year	Target name	Target nation	Bidder name	Bidder nation
1[1]	15,371	2005	HVB Group	Germany	UniCredit	Italy
2	13,853	2004	Abbey	United Kingdom	BSCH	Spain
3	11,229	2000	CCF	France	HSBC	United Kingdom
4	7,169	2000	Bank Austria	Austria	HVB Group	Germany
5	5,865	2005	Banca Antonveneta	Italy	ABN Amro	Netherlands
6	4,779	2000	Unidanmark	Denmark	Nordic Baltic Holding	Sweden
7	4,135	1997	Merita Oyj	Finland	Nordbanken	Sweden
8	4,090	1997	Banque Bruxelles Lambert	Belgium	ING	Netherlands
9	3,302	1999	Christiania Bank og Kreditkasse	Norway	MeritaNordbanken Oyj	Finland
10	2,695	2005	Bank Austria Creditanstalt	Austria	UniCredit	Italy
	57,915	Other deals				
	130,403	Total value of deals in Western Europe				

Note:

1 Excludes the simultaneous offers for the remaining stakes in HVB's Austrian (Bank Austria Creditanstalt AG) and Polish (Bank Przemyslowo-Handlowy PBK SA) units, collectively valued at approximately €3.4bn

Source: PricewaterhouseCoopers analysis of Dealogic data

The top 10 deals (by deal value) accounted for c. 56% of the 185 cross-border deals involving the acquisition of stakes in western European banks by other European banks during the period 1996–2005.

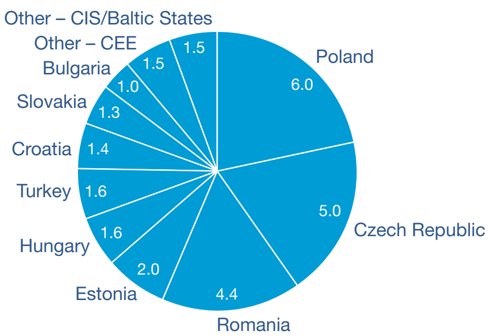
Many banks have sought to grow beyond their home markets by merging with or acquiring stakes in banks in neighbouring countries that may have faced similar domestic market conditions. For example, over the last 10 years, there have been 16 transactions with a total value of €16bn between banks in the Scandinavian countries. Such consolidation has resulted in the creation of financial institutions that have significant operations in a number of neighbouring geographical markets.

Most of the top 10 cross-border bank deals in the period 1996–2005 involved retail banking as some of the larger banks have begun to grow their European footprint through the acquisition of retail banks in other western European countries. The most notable examples of such activity are Unicredit's acquisition of HVB, BSCH's acquisition of Abbey, HSBC's acquisition of CCF and ABN Amro's acquisition of Banca Antonveneta. It is notable that this type of acquisition has become more prevalent in the last couple of years. Arguably, this trend is likely to continue with the larger domestically focused banks most at risk of takeover.

Acquisition of banks in 'emerging' Europe

Over the last 10 years, the growth strategies of many banks in the developed economies of western Europe have involved, inter alia, expansion into 'emerging' Europe: over the last 10 years, European banks have spent €27bn on 89 transactions, acquiring stakes in banks in 'emerging' Europe.

Figure 10: Value of bank M&A deals in 'emerging' Europe analysed by nationality of the target 1996-2005 (€bn)



Source: PricewaterhouseCoopers analysis of Dealogic data

This reflects the attractiveness of the 'emerging' European countries' banking markets, which offer more attractive growth opportunities (both in terms of economic growth rates as well as increasing penetration of financial services products) than many domestic markets in western European countries.

The privatisation programmes implemented by the 'emerging' European governments in the late 1990s enabled western European banks to enter these markets through the acquisition of state-owned banks.

In our view, the phase of growth involving the acquisition of former state-owned banks in CEE has almost reached maturity because foreign ownership of bank assets in these markets is now high (e.g. it averages to approximately 66% in the 10 new EU member states)[1] and the number of banks to be privatised in the future is lower.

Consolidation opportunities, however, exist among the foreign-owned operations in the CEE countries (this was a key feature of the recent merger of Germany's HVB and Italy's Unicredit, which both had sizeable businesses in CEE). M&A activity in 'emerging' Europe in the immediate future is likely to focus on the less mature markets of the CIS (Russia, Ukraine, etc.), where potential targets remain more readily available. Ukraine, in particular, has been very active, with many of the leading privately held banks having been the target for acquisition by international banks in 2005 and 2006.

A key feature of M&A activity in 'emerging' Europe has been regional expansion, for example, with Austrian, German and Italian banks expanding into the neighbouring markets of the Czech Republic, Croatia, Poland and Hungary. Figure 11 shows the top five investors (by value) in banks in 'emerging' Europe.

Figure 11: Top five investors (by value of deals) in banks in 'emerging' Europe 1996-2005

Bidder name	Bidder nation	Target nations	Agg. deal value (€bn)
Erste Bank	Austria	Croatia, Czech Republic, Hungary, Romania, Serbia and Montenegro, Slovakia	6.3
UniCredit	Italy	Bulgaria, Croatia, Czech Republic, Poland, Turkey	2.5
KBC/ Almanji	Belgium/ Netherlands	Czech Republic, Hungary, Poland, Slovakia	2.4
Swedbank	Sweden	Estonia	1.7
Societe Generale	France	Czech Republic, Romania, Russian Federation, Slovenia	1.6

Source: PricewaterhouseCoopers analysis of Dealogic data

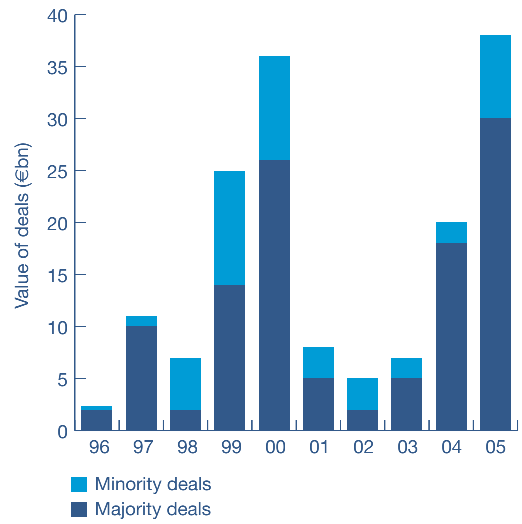
1 Source: European Central Bank

Key trends: Majority or minority deals?

As shown in Figure 12, the acquisition of controlling stakes in banks ('majority deals') accounted for the bulk of M&A activity (measured by deal value) over the last 10 years.

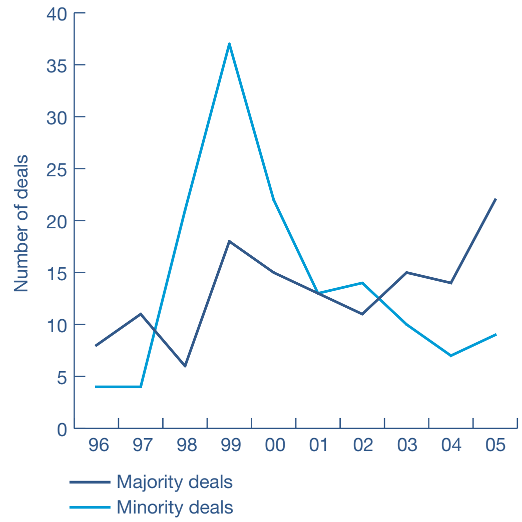
Interestingly, over the last 10 years, the total number of European cross-border banking deals involving minority deals has almost equalled that for majority deals. However, as is shown in Figure 13, the balance has swung from a preponderance of minority deals before 2002 to a greater prevalence of majority deals thereafter.

Figure 12: Value of European banks' cross-border bank M&A activity in Europe 1996-2005

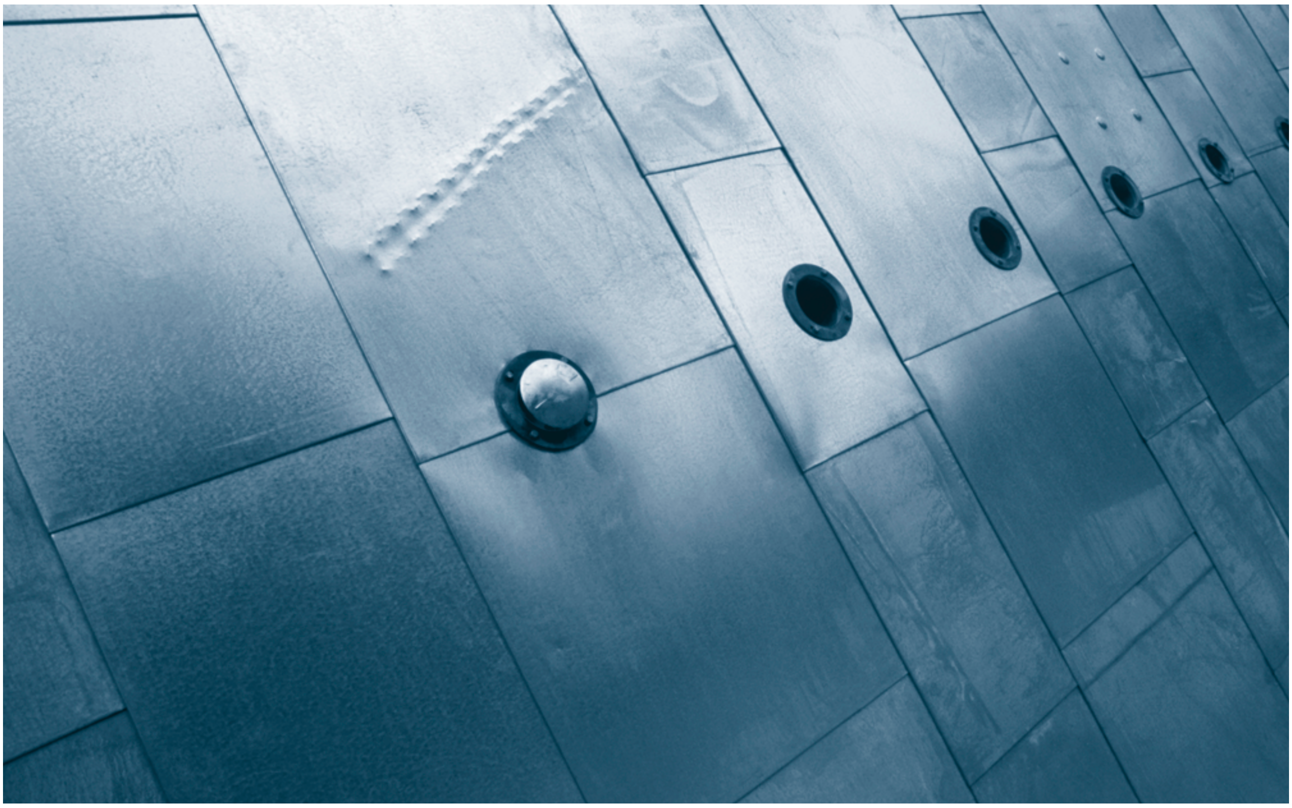


Source: PricewaterhouseCoopers analysis of Dealogic data

Figure 13: Number of European cross-border bank M&A deals undertaken by European banks 1996-2005



Source: PricewaterhouseCoopers analysis of Dealogic data



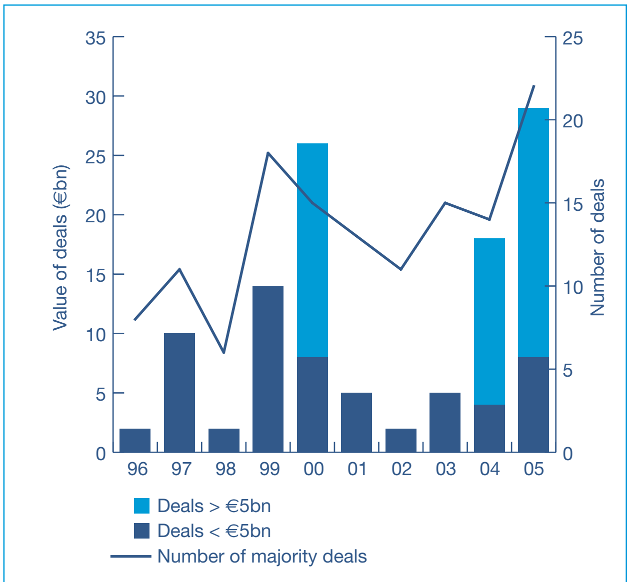
Majority deals

Over the last 10 years, European banks have spent €114bn on 133 transactions, acquiring controlling stakes in European banks. However, only five of these deals have had a deal value greater than €5bn, three of which have been announced in the last two years and the remaining two in 2000 at the height of the last equity bull market.

In 2005, the number (22) and value (€30bn) of European cross-border bank M&A deals that resulted in a change of control exceeded the previous peak of 1999/2000 – we believe that there are a number of reasons why this trend may continue *(see page 5)*.

Multi billion euro deals are few and far between

Figure 14: European cross-border majority bank M&A deals by year



Source: PricewaterhouseCoopers analysis of Dealogic data

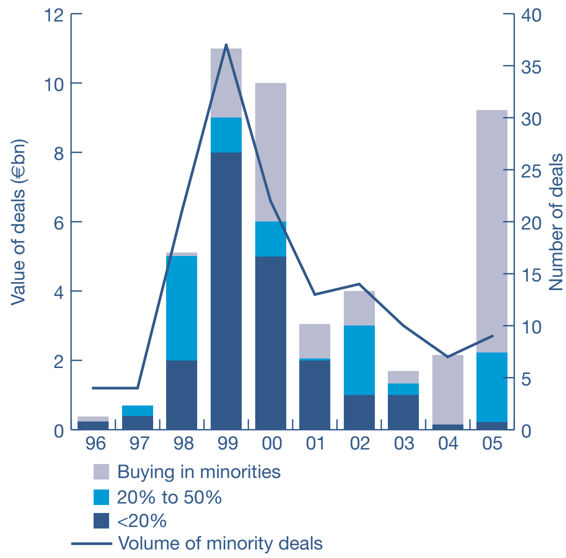
Minority deals

Over the last 10 years, European banks have spent €44bn acquiring 141 minority stakes in other European banks.

Approximately two-thirds of this activity (measured by number of deals) has involved banks in western Europe taking minority stakes in other western European banks. The remaining activity relates to the acquisition of minority stakes in banks in 'emerging' Europe.

As shown in Figure 14, after peaking in 1999, both the volume and value (excluding the offers made in 2005 by UniCredit to minorities in the HVB subsidiaries) of European cross-border minority bank deals have declined significantly.

Figure 15: European cross-border minority bank deals (1996-2005)



Note: Buying in minorities in 2005 includes the €3.4bn offer made by UniCredit to minorities of HVB's subsidiaries in Austria (Bank Austria Creditanstalt AG) and Poland (Bank Przemyslowo-Handlowy PBK SA)

Source: PricewaterhouseCoopers analysis of Dealogic data

The key features of minority deals have been as follows:

- **Acquisition of strategic stakes.** During the late 1990s, many of the larger European banks sought to position themselves, to take advantage of the consolidation that was expected to occur, following the introduction of the euro by acquiring 'strategic' (i.e. minority) stakes of up to 20%, predominantly in their counterparts in other western European countries.

- **Acquisition of some influence over target banks.** A number of the larger European banks chose to grow their businesses by acquiring larger stakes, i.e. between 20% and 50%, which gave them some influence over the financial affairs of the target, but did not give them control.

  Such strategies more effectively managed transaction risk as it gave the bidder the opportunity to gain access to, and learn about, a new market as well as recognising the realities of the M&A market, i.e. that many vendors did not wish to give up control; so buying a minority stake was the only type of deal that could be done.

- **Buying out minority investors.** Approximately 35% of minority deal activity (measured by value) relates to banks acquiring the outstanding shares held by minority investors in subsidiaries. This illustrates an important feature of bank M&A in Europe whereby, in many cases, European banks have sought to manage transaction risk and facilitate M&A by deliberately not seeking to initially acquire 100% of the share capital of the target. Such activity may, though, have acted as a drag on future expansion, as M&A budgets have been deployed to buying in minorities as opposed to investing in new targets.

In our view, European cross-border minority bank deal volumes in Europe are unlikely, in the immediate future, if ever, to recover to 1999 levels, as historically the strategy of acquiring minority stakes has not resulted in the expected follow-on M&A deals.

Interestingly, while European banks appear to have abandoned minority deals in Europe, they have been spending substantial sums in the last couple of years acquiring minority stakes in banks and other businesses. In China examples include: HSBC's €1.4bn investment to acquire 19.9% of Bank of Communications, a consortium led by RBS's €1.4bn proposed investment to acquire 10% of Bank of China; UBS's proposed €414m investment to acquire 1.6% of Bank of China; and Deutsche Bank's proposed €272m investment to acquire 14% of Hua Xia Bank. The difference here is, however, that the Chinese government has limited the percentage stake that foreign banks can acquire.

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