European bank M&A

Case for cross-border consolidation remains weak; but domestic deals show potential

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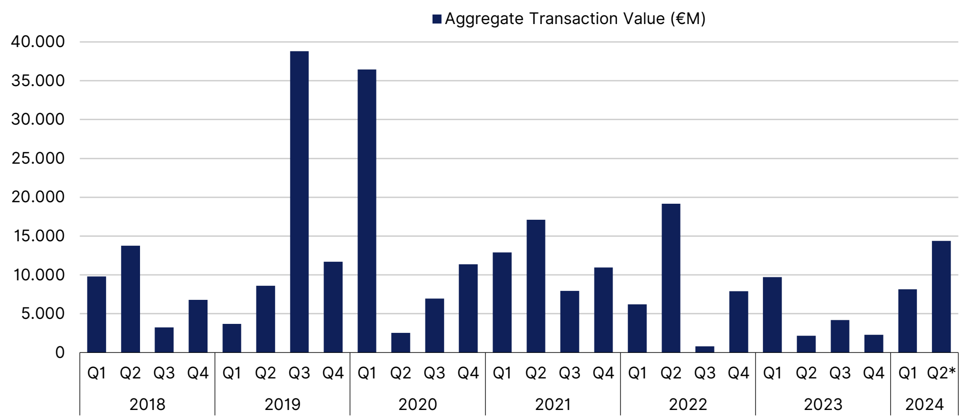
After several lacklustre quarters, the first five months of 2024 witnessed a rise in large bank M&A announcements, reigniting speculation that a new wave of consolidation may be imminent for European banks. Despite this renewed activity, the case for cross-border mega-mergers remains weak, but there is significant potential for domestic consolidation in Italy, Spain, Germany and the UK.

Politicians and regulators continue to promote cross-border banking consolidation. Notably, recent comments by French President Emmanuel Macron have raised expectations that the banking sector may finally be ripe for this. But we believe President Macron was expressing the view that more tangible integration steps must be put in place to facilitate the emergence of a truly unified European banking sector.

The already highly consolidated French banking sector faces profitability pressures due to country-specific issues (including in domestic retail) making the prospect of a mega-merger involving French banks unlikely at this stage.

Figure 1: Pick-up in European bank M&A activity in 2024



Source: S&P CapitalIQ, Scope Ratings
*Q2 data to end of May. Data for European Banks, Financial Services, Capital Markets

Several top bankers have spoken out following Macron's comments to highlight the significant hurdles for cross-border consolidation. The economics of international bank M&A are challenging: cost synergies are much more limited given the lack of overlapping distribution networks, and the potential for regulatory ring-fencing limits funding cost synergies. The European Banking Union remains incomplete, which restricts the fungibility of capital and liquidity across borders.

Domestic deals more likely to create value

Still room for domestic consolidation

Contrary to the challenges of cross border mergers there is still room for domestic consolidation, which holds greater potential for value creation thanks to cost synergies both in physical distribution and in overlapping centralized functions.

Revenue synergies are also achievable as domestic deals come with improved market and pricing power on top of cross-selling opportunities, while funding synergies are not hindered by jurisdictional ringfencing.

Domestic deals also tend to carry less fewer integration risks than cross border deals, thanks to a closer cultural alignment between merging entities, greater knowledge of the market and lower risk of political interference.

France

French banks: limited domestic opportunities push the boundaries

The French market is already at an advanced state of consolidation, with six large banking groups dominating the retail market. Any deal between them is unlikely given complex governance arrangements such as co-operative structures and likely competition challenges. Consequently, French banks have already been looking for growth opportunities outside of France and are among the most diversified in Continental Europe. Their recent activity points to well thought-out bolt-on deals in markets in which they are already present, such as Italy, rather than aggressive entries into new markets.

UK

UK banks: ongoing consolidation in building societies

The UK banking sector is moderately concentrated but not to the extent that it excludes further consolidation. M&A among the largest players is unlikely, given the significant size and complex international operations of HSBC and Barclays, the high market shares of Lloyds and NatWest, and the firm ownership of Santander UK by its Spanish parent. However, bolt-on domestic deals are still possible for the top five banks if they present strong industrial and financial rationales. Barclays' acquisition of Tesco Bank and its long-term partnership in consumer credit with the retailer could be a blueprint.

We also believe deals are possible between building societies and within the space occupied by challenger banks and fintechs. Recent activity points to the larger building societies having an appetite to increase their scale.

The acquisition of Virgin Money by Nationwide Building Society – subject to an inquiry by the Competition & Markets Authority with a phase 1 deadline of 26 July 2024 – will, if approved, significantly expand Nationwide's domestic market presence, accelerate its strategy to diversify its product suite, and cement its leadership in mortgages and within the building society space. While the offer announcement contained many reassurances to Virgin's workforce, we understand a key value driver for the deal is the medium-term prospect of cost savings from branches and overlaps in central functions.

Similarly, Coventry building society's acquisition of The Co-Operative Bank will solidify Coventry's standing as the second-largest building society, with close to GBP 100bn in assets.

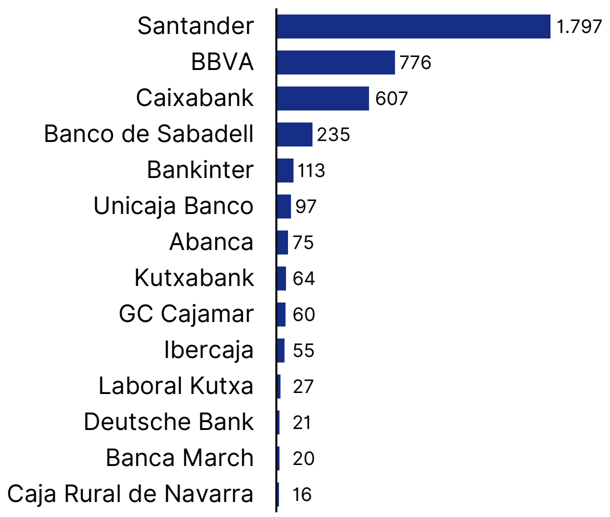
Spain

Spain: Barbell shaped market structure shapes competitive dynamics

In Spain, BBVA's bid for Banco de Sabadell is testament to the attractiveness of the Spanish market, which with its consolidated structure, largely retail customer bases and the country's strong economic performance offers potential for sustainably high returns. Beyond the BBVA-Sabadell deal, which is still subject to regulatory approvals and shareholder acceptance, room for further transformational deals is limited, as the sector is barbelled, with mega banks at one end (Santander, BBVA, CaixaBank) and regional institutions at the other.

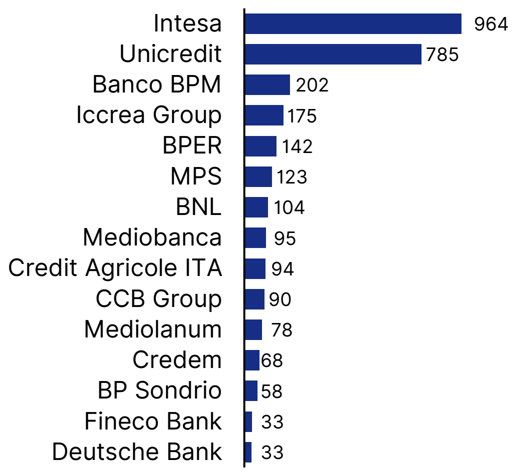
But we do not exclude further consolidation among the former regional savings banks, as they struggle to match the digital service offerings of larger competitors. At the same time, the relevance of regional savings banks remains an enduring characteristic of the sector. With the recent lift off in margins and profitability, there is no immediate pressure to consolidate.

Figure 2: Spanish banks by total assets (EUR bn)



Source: S&P Capital IQ, Scope Ratings.

Figure 3: Italian banks by total assets (EUR bn)



Source: S&P Capital IQ, Scope Ratings.

Italy

Italy: Strong performance pours cold water on M&A cycle

The Italian sector is similarly barbelled, with Banca Intesa Sanpaolo and UniCredit dominating the market. However, here we see greater room for consolidation, especially among medium-sized groups, and this could eventually lead to the emergence of a third major group. The Italian banking sector remains one of the most fragmented in Europe and several former *popolari* banks may look to combine to strengthen their competitive positions, a process that could involve UniCredit as well. French banks could also act as consolidators, given their long-standing market presence and expertise.

Italian banks have significant excess capital, including relative to their internal targets, enabling them to engage in M&A. However, cash deals no longer come as cheap as they used to, due to the higher interest-rate environment which has crystallised the value of large captive deposit bases into higher share prices and valuations, and removed the urgency for deals. Banca MPS, once a prime takeover target, has largely been cleaned up and returned to private ownership, removing the need for the Italian government to push for a quick deal.

In-market consolidation deals prevail in CEE

Rather, large Italian banks have been consolidating their positions in Romania. UniCredit is merging its Romanian subsidiary with the newly acquired Alpha bank in Romania, becoming the third-largest lender in the country. Similarly, Intesa will double its assets in Romania following the acquisition of First Bank. Meanwhile, Banca Transilvania agreed to purchase the local unit of Hungary's OTP Bank to pinpoint its position as Romania's biggest bank by domestic assets. Domestic consolidation is also ongoing in Hungary, Serbia, Greece and Cyprus.

Germany

Germany: consolidation possible within each pillar

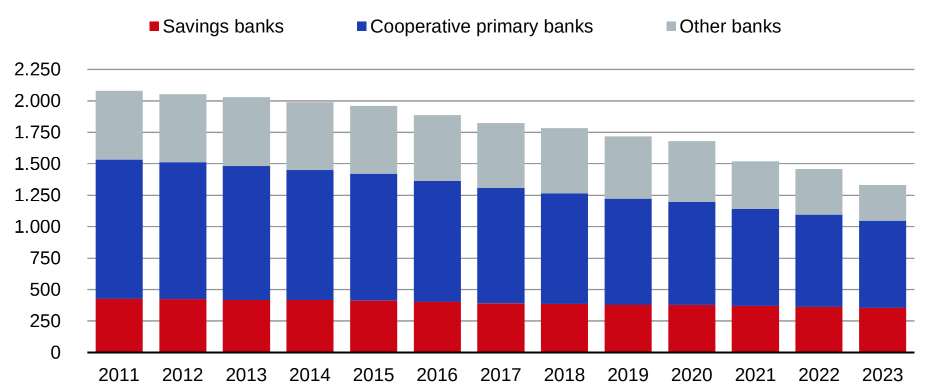
Germany's three-pillar banking system offers very distinct M&A potential for the respective sectors. In the private sector, M&A speculation centres on Deutsche Bank and Commerzbank or a possible transaction involving both. As the business models of the two are complementary, a merger would result in a much more rounded business model and create significant cost and revenue synergies . This is an area in which German banks have caught up significantly over the last two years although they still lag their European competitors.

A transaction was rejected in 2019, as the execution risks for all large bank mergers remain significant. Nevertheless, we believe an in-market transaction is still the safer option compared to a riskier cross-border transaction.

Another area for consolidation is the savings bank sector (SFG). Even if the idea of a "super Landesbank" is off the table, at least for the time being, we consider the current Landesbank system to be too fragmented and ultimately responsible for the sector's below-average profitability. At the same time, it promotes a focus on the project finance business, including commercial real estate financing, which represents a concentration risk for the SFG sector due to its higher cyclicality.

As in Italy, there is no immediate need for action at the local savings banks, as the sharp rise in interest rates has led to a significant improvement in the financial results of the local savings and co-operative primary banks. Nevertheless, a degree of consolidation is also taking place within the two sectors, triggered by the low interest rates environment and associated cost pressures. Since 2010, the number of local institutions has fallen by 18% for savings banks and 38% for co-operative banks. In 2023, the number of savings banks fell from 362 to 353 and co-operative banks from 737 to 697.

Figure 4: The number of banking institutions in Germany continues to decline



Source: Bundesbank, Scope Ratings.

Selected research available on scoperatings.com:

Italian banks quarterly: benign operating conditions support performance, May 2024

Bank capital quarterly: dealing with the TBTF dilemma, May 2024

Strategic case for Western European banks in CEE remains intact, April 2024

Norwegian Savings Banks: strong profitability set to continue, April 2024

EU banks NPL Heatmaps: modest increases to continue, April 2024

French banks quarterly: Heading into a more volatile business environment, April 2024

German savings banks and co-operative banks well positioned to face challenges, March 2024

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Italian bank quarterly: upbeat guidance to better earnings in 2024 should be treated with caution, February 2024

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European banking outlook: sound fundamentals support credit profiles but profitability will decline, January 2024

French banks outlook: resilient credit profiles underpinned by recovering retail margins, Jan 2024

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