

More consolidation within Germany's Landesbanken sector both overdue and welcome



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With a union of Commerzbank and Deutsche Bank still in the ether, the future of NordLB has moved centre-stage. Are Germany's Landesbanken about to enter a new stage of consolidation, as the notion of a public-sector banking behemoth gains traction?

Talk of a merger of German's Landesbanken has persisted since the global financial crisis, but there have been few transactions recently. Earlier this year, the states of Hamburg and Schleswig-Holstein and the Savings Bank Association of Schleswig-Holstein sold HSH Nordbank, the highly troubled Landesbank with twin bases in the Northern German cities of Hamburg and Kiel, to a consortium of private equity firms and alternative asset managers, including Cerberus, J C Flowers, GoldenTree Asset Management, and Centaurus Capital.

Last year, NordLB itself acquired Bremer Landesbank; while Allianz sold its 90% stake in Oldenburgische Landesbank to Bremer Kreditbank, the bank owned by Apollo, Grovepoint Capital and the Teacher Retirement System of Texas.

Moving to next stage?

Discussions between potential external investors and NordLB's regional state owners have been taking place over the past few months as a comprehensive plan takes shape to improve the capital ratios of the bank, beset by shipping NPLs. The market expects NordLB to be borderline in the forthcoming EU stress tests (results to be made public on November 2), or even to be in need of more capital.

A takeover by Frankfurt-based Landesbank Hessen-Thüringen (Helaba) seems to have caught the imagination of the market and, according to media reports, of regional officials too. Media reports talk of future additional add-on mergers involving DekaBank, LBBW and Berlin Hyp to form, over time, Germany's second largest banking group.

"A merger of NordLB into Helaba would be a very positive development indeed," said Sam Theodore, team leader for financial institutions at Scope Ratings. "It would address one of the remaining relative weaknesses within the Landesbanken sector, namely NordLB, which has faced several challenges through the post-crisis years."

"A second wave of consolidation within the public banking sector to include an enlarged Helaba, LBBW, and Deka – and ideally BayernLB as well – may not emerge in the short term, as none of the players is in a particularly weak position either financially or with respect to its business model," Theodore continued. "But the chance of the ultimate 'one Landesbank to include all Landesbanks' is far from non-negligible. If a true and more determined process of consolidation were to take place within the German Landesbank sector, it would represent a long overdue strengthening of the public banking sector in particular, and of the German financial sector in general."

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Fragmented

Theodore says the highly fragmented structure of Germany's public banking sector – a multitude of regional Landesbanken, regional development banks and cohorts of larger and smaller domestically-focused Sparkassen – has become increasingly obsolete and ill-equipped to support the export-oriented German economy, the European champion by a long stretch.

“One single very large wholesale institution – encompassing the entire range of activities, from domestic and international corporate lending to capital markets activities and asset management – would significantly strengthen the public-sector pole of Germany's banks and represent an essential step from the past and positioning for the present,” Theodore said. “And not a moment too soon, as the next step should clearly be to re-position the core entities of the public-sector financial system – the Sparkassen – into the digital era.”

Private bidders are also interested in NordLB. Commerzbank has reportedly made a non-binding bid; so, according to reports, have private equity firms Apollo, Cerberus and Advent. If a public-sector solution is pursued, NordLB's current owners could inject additional capital into the bank. If, on the other hand, a private sale is preferred, the public owners could back out in a full privatisation scenario.

At present, 59.1% of NordLB is owned by the State of Lower Saxony. The Lower Saxony Savings Banks and Giro Association owns 26.4%, and small minority stakes are held by the State of Saxony-Anhalt (5.6%), the Saxony-Anhalt Savings Banks Association (5.3%) and the Association of Mecklenburg-Western Pomerania Savings Banks (3.7%). Whatever course merger negotiations take, they are likely to be a source of political sensitivity.

Far too many Sparkassen

On the subject of Sparkassen, Theodore believes there are still far too many institutions. Despite the move to intra-sector consolidation, the DSGV still has 540 member-institutions with 18,000 branches and 312,800 employees. And they are still anchored in the Regionalprinzip, where each entity sticks to its own local market.

The S-Gruppe (which includes the Landesbanken and the Sparkassen, among others) is displaying conservative and in general reassuring financial fundamentals. “This is despite the weak profitability that raises howls in the market and discomfort among regulators but is not at all viewed with dismay by the S-Gruppe's top management itself,” Theodore says.

“The fact that the group is not publicly listed removes equity market pressure to enhance profits – something that the likes of Deutsche Bank or Commerzbank are relentlessly subjected to. But, reassuring financial fundamentals aside, the S-Gruppe remains chained to a weak group structure, with far too many inefficient players,” Theodore adds.

“Ideally, one single all-encompassing wholesale subsidiary (the merged Landesbanken) alongside a smaller number of financially healthy and interconnected Sparkassen would plausibly represent one of the strongest and largest financial groups in Europe – something that Germany has owed the Continent for some time.”



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