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M&A DEALS UPDATE: INTESA SP – UBI BANCA

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CHALLANGES IN THE BANKING INDUSTRY

European banks are running out of options to protect profitability. Negative interest rates, new regulations and a sluggish economy worsened by the COVID-19 outbreak are putting substantial pressure on banks' returns.

With negative LIBOR rates for all maturities, the European Central Bank is putting substantial pressure on banks' net interest income, the revenue they generate from lending. At the same time, new global rules on capital, known as Basel IV, are also expected to put pressure on banks when they are phased in between 2022 and 2027. Additionally, a new global threat is striking an already weak economy, preventing institutions from profitable investment opportunities: the COVID-19 outbreak is forecasted to reduce global GDP growth by 0.5% in 2020, according to S&P Global Ratings.

The situation is even worse for regional banks which are suffering from competition coming from both big players and non-traditional lenders such as fintech companies.

As North American banks benefit from higher rates, lower taxes and better loan growth, and report a return on equity of 16%; their rivals in Western Europe are struggling to maintain a tiny 6.5%. These results are linked to different factors. The first is the recovery after the slump in 2008 which has characterized the gap between the US banking sector and the European one. Furthermore, the presence of negative interest rates has created incredible difficulties in identifying investment opportunities for European banks that are still suffering in terms of profitability for this reason.

In this framework 'business as usual' cost-cutting will not be enough to save European players. That is why some M&A advisers are predicting a string of deals to consolidate the sector. As cross-border mergers are still seen as too complex, many bankers expect a series of domestic transactions happening in 2020-2021. It is also highly likely that the European Central Bank and the different governments will take action to assess the delinquent loans and support the flow of credit into the system (despite the issuing business being heavily impacted by COVID-19).

INTESA SAN PAOLO OVERVIEW

Intesa Sanpaolo S.p.A., listed on the Italian Stock Exchange, is one of the leading European banks and the largest Italian bank in terms of market capitalization (€40 bn). The bank, which is effectively a universal bank, attracts deposits (18% market share) and offers consumer credit, asset management, internet banking, investment banking, securities brokerage, factoring, and lease financing services. The bank operates through 3800 branches throughout Italy, and 1000 offices in another 25 countries elsewhere in Europe, Asia, and the United States.

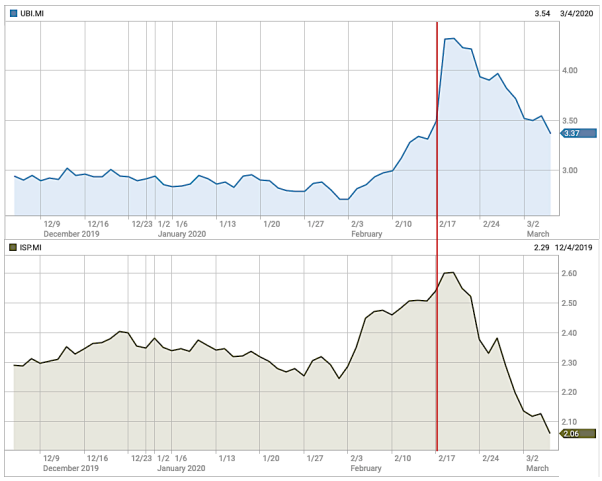
UBI BANCA OVERVIEW

UBI Banca - Unione di Banche Italiane S.p.A. is the third largest Italian group in terms of market capitalization (€4.02 bn) after Intesa Sanpaolo and UniCredit. The bank attracts deposits and offers business loans, pension and investment fund management, mortgages, insurance, and online securities brokerage services. UBI Banca operates through network banks and performs centralized functions of governance, control, and organization for those banks.

PUBLIC TENDER OFFER

On February 17th, Intesa Sanpaolo announced a €4.9 bn public tender offer for the acquisition of 100% of the shares of its competitor, UBI Banca. Intesa will offer 17 shares for every 10 shares of UBI. The size of the deal suggests a valuation of UBI Banca at an 11.4x P/E multiple (or 12x forward P/E for the year 2020), which is a 28% premium to the closing price on February 14th. The premium is in line with a historical value of 25%-30% for a public tender offer.

The market has been favorable to the transaction, thought of as a win-win deal. This is demonstrated by the fact that contrary to the expected usual fall in stock price of the bidder, the shares of Intesa gained 4%. At the same time, UBI stocks gained +26%.



Source: Reuters as of 05/03/2020

The offer was unsolicited and unexpected by UBI Banca. It will be effective in June 2020. As a result of this common belief among UBI's shareholders, two of the three shareholders' groups (CAR, voting trust representing the 17.7% of the bank capital and 'Patto dei Mille', 1.6%) have unanimously rejected the proposal, defined by Victor Messiah, CEO of the group, as in contrast with the values of UBI Banca and its stockholders.

The deal would be the biggest European banking acquisition in more than 10 years, according to data compiled by Bloomberg.

Intesa Sanpaolo has set a minimum 66.7% acceptance threshold and is counting on the institutional investors that own more than 50% of UBI's capital for their approval. Meanwhile, a group of UBI's investors holding 18% of the bank's share capital dismissed Intesa's bid as unacceptable.

To address potential antitrust concerns once the deal goes through, Intesa said it had signed a deal to sell 400-500 branches of the combined entity to BPER Banca and, possibly, some of UBI's insurance assets to UnipolSai.

If the offer is successful, Intesa would quickly delist UBI and merge with it, aiming to complete the transaction by the end of the year.

RATIONALE OF THE PROPOSAL

Intesa said that it had picked UBI because it has a similar business model and operates mainly in Italy's wealthier north, which would minimize integration risks.

The combined entity would form the seventh largest European lender with €8.7 bn in net interest income and almost €1 tn in total assets. Combined revenues would amount to €21.6 bn, based on 2019 financial data. The deal is forecast to generate €730 mn in annual pre-tax synergies, mostly through cost cuts after 5,000 voluntary layoffs, partly compensated by new hiring.

The objective is to achieve net profits of over €6 bn in 2022, leaving the estimate for the return on Intesa's tangible equity unchanged at 12.2%. Indeed "while the growth in earnings per share is not large given the size of UBI compared to Intesa, the main rationale is to acquire a flow of profits and create synergies to support dividends after 2020 with Intesa aiming at an 8% annual return," JP Morgan analysts said.

As for UBI, the transaction is seen as "neutral on earnings per share in 2021 and increasing by 3% in 2022 in the event of two-thirds of the estimated synergies being achieved".

CONCLUSION

The outcome of the proposal is not easily foreseeable since the UBI shareholders' decision will be crucial and will come up only in the following weeks. It is also uncertain given the current critical situation caused by the COVID-19 crisis.

As for now, what is certain is that Intesa, which has already presented the official prospectus of the offer to CONSOB, will not increase its offer in case of a rejection.

April 27th ,the day of the extraordinary Intesa shareholders meeting, will be a crucial date to understand the real chances of reaching an agreement and reaching the end of this difficult process.The shareholders will decide whether to delegate the task of undertaking an increase in share capital to the Board of Direectors. In case of a negative outcome, Intesa might look at alternative mergers. One possible target is Banca Monte Dei Paschi di Siena SpA and it will be in a banking environment undoubtedly characterized by consolidation in order to increase competitivity in the banking sector due to technological innovations and online services, as well as to hedge against the profit margins erosion linked to low-interest rates.

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