Will optimism prevail in the new reality?

Global Banking M&A Trends 2021

—

February 2021

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Foreword

The year 2020 will be remembered for many things - deal flow in global banking, however, won't be one of them. Though banking industry fundamentals remained sound, the operating environment – triggered by the global economic slowdown and COVID-19 – hardened. Accordingly, global deal activity declined 26 percent and 41 percent, respectively, in volume and value compared to 2019. The US, India, China, Italy and the UK remain the most active markets as domestic banking deals continue to dominate, making up nearly three-quarters of total activity.

COVID-19 accelerated talk of M&A and continues to shape much of the European banking landscape. Weak profitability remains a sector-wide concern amid the combined pressures of negative rates on net interest income, sluggish progress in fee generation and limited progress on cost measures. Additionally, a spike in loan-loss provisions following an anticipated increase in NPLs has trimmed down post-tax profits. These sector challenges and weak valuations suggest an uptick in sector M&A is forthcoming.

In 2H2020, sector consolidation had already begun somewhat with a few large deals circulating. The recognition of "badwill" by European regulators might make deals more attractive going forward, especially for high-value transactions. It may also act as a catalyst for domestic rather than cross-border transactions in the near-term. Scale alone however will not be enough to drive deal activity – other factors like margin considerations, NPLs, business model fit, scope for meaningful cost cuts and potential value creation will take priority. The drive to consolidate, from a supervisory perspective, is a logical conclusion to remedy some long-term ECB-cited challenges facing the European banking sector.

While it is still difficult to decipher how the M&A market may evolve in 2021, there are signs of life. Though a global v-shaped economic recovery appears unlikely, several major themes could ignite near-term deal activity. These include:

— A drop-in valuation has created a buyers' market, especially for cash-rich private capital players and PE.

— Digital innovation has normalized, and progressive banks are focusing on the acquisition of digital capabilities like AI and advanced analytics.

— Organic capital generation alone remains insufficient to restore profitability; thus, banks are looking for options such as new capital issuance, sale or closure of portfolios etc.

— Global banks are increasingly embedding environmental, social and governance in their risk-management framework. We expect banks to substitute existing business portfolios, though such portfolio transitions might take time.

— Early signs of asset quality deterioration were seen in 2020. We expect more defaults to materialize in 2021.

— Regulators in various countries/regions are either relaxing stringent capital requirements or easing deal restrictions, liberalizing and increasing foreign participation to foster deal activity.

> After the COVID-19 pandemic, the banking industry is experiencing a strong consolidation momentum, especially in Europe. M&A is a way for banks to face the persistent low profitability and to reduce costs thanks to synergies, thus enhancing competitiveness.
>
> Some of the largest banks are currently discussing about potential consolidation.
>
> Larger and more profitable banks are also asked by national governments to rescue weaker banks with banking regulators currently encouraging banks to merge.

Giuseppe R Latorre
Global Financial Services Deal Advisory Lead
KPMG in Italy
E: glatorre@kpmg.it

Global banking M&A | 2020

Global banking M&A market slumped in 2020, both in volume and their reported size. Deals that were close to signing or execution were moved forward and completed while those in initial phase or near were delayed. During the period, an uptick in non-domestic transactions was seen while at regional level, ASPAC deal activity remained relatively buoyant.

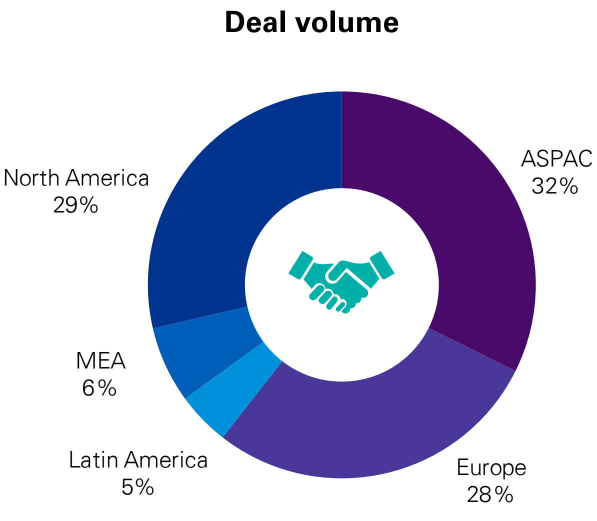
Banking deals landscape in 2020

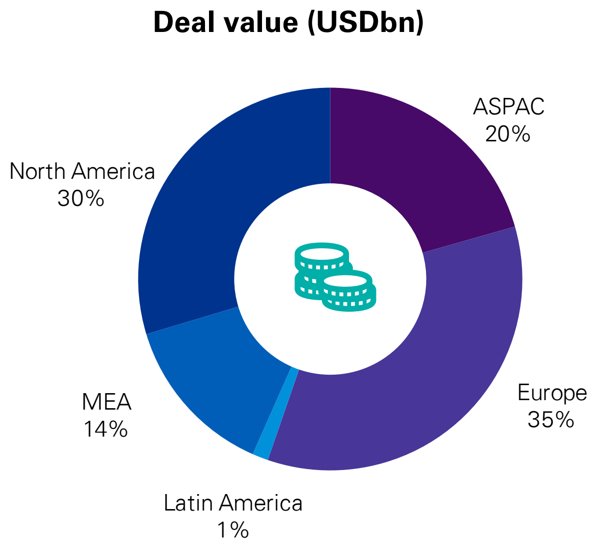
1,391 deals ▼ 26% (2019-20) worth USD203 billion ▼ 41% (2019-20)

	Global banking deals [1][4] (volume announced)	Global value of banking deals announced [2] (USD billion)	Non-domestic banking deals[3] (percent of total banking deals)
2009	2,321	285	15%
2013	1,653	150	18%
2015	1,961	259	20%
2019	1,892	343	22%
2020	1,391	203	29%

Notes:
(1) Deals announced include pending and completed deals.
(2) Deal value represents total value of announced transactions where value is disclosed publicly. Deal value is ranking value including net debt of target.
(3) Non-domestic banking deals include regional and inter-continental (excludes domestic) deals.
(4) Banking deals include payment deals.
Source: ThomsonOne

Regional break of banking deal volume and value | 2020





Top 10 core banking deals in 2020[5]

1. **Samba Financial Group SJSC**
   Acquirer: National Commercial Bank SJSC
   USD15.6bn
2. **BBVA USA Bancshares, Inc.**
   Acquirer: PNC Financial Services Group
   USD11.6bn
3. **Ahli United Bank BSC**
   Acquirer: Kuwait Finance House
   USD9.7bn
4. **Bank of Jinzhou-Credit assets**
   Acquirer: Beijing Chengfang Huida
   USD6.4bn
5. **TCF Financial Corp**
   Acquirer: Huntington Bancshares Inc,OH
   USD5.9bn
6. **China Everbright Bank Co Ltd**
   Acquirer: China Everbright Group Ltd
   USD5.4bn
7. **Bankia SA**
   Acquirer: CaixaBank SA
   USD5.1bn
8. **UBI Banca SpA**
   Acquirer: Intesa Sanpaolo Spa Bancshares Inc
   USD4.7bn
9. **CenterState Bank Corp**
   Acquirer: South State Corp
   USD3.2bn
10. **CIT Group Inc (CIT)**
    Acquirer: First Citizens Bancshares Inc
    USD2.2bn

Cross border transaction

Notes:
(5) Top 10 core banking deals (excluding payments, fintech transactions and other banking related/support services) only basis deal value.

Global banking M&A perspectives for 2021

For 2021, we anticipate several signs of hope, but challenges will remain. As economies re-open, vaccines are rolled out and risk appetite returns, we expect deal activity to slowly gain momentum with certain underlying drivers in place. Below, is a summary of these themes or changes will play out in 2021.

01

European banks are losing fire power against their American and Asian peers — a significant gap in size relative to market capitalization of top banks remains for European lenders.

Pressures continue banks' profitability driven by relentless weight on net interest income, slow progress in fee-building capacity and higher cost-efficiency ratio, consequently, downgrading the valuations of European lenders well below book value. Click to read further.

02

Few larger-scale domestic deals are circulating in 2H2020. The drive to consolidate, from a supervisory perspective will remedy some industry challenges. In-market M&A, particularly among mid-size banks, may benefit from significant badwill. In 2021, completion of on-going deals is expected, and more bank mergers may occur in over-banked markets.
Click to read further.

03

Cross-border transactions and mergers in Europe may still take time to accelerate, hindered by difficulty in identifying synergies, smoothing structural impediments, regulatory constraints and accounting headwinds.
Click to read further.

04

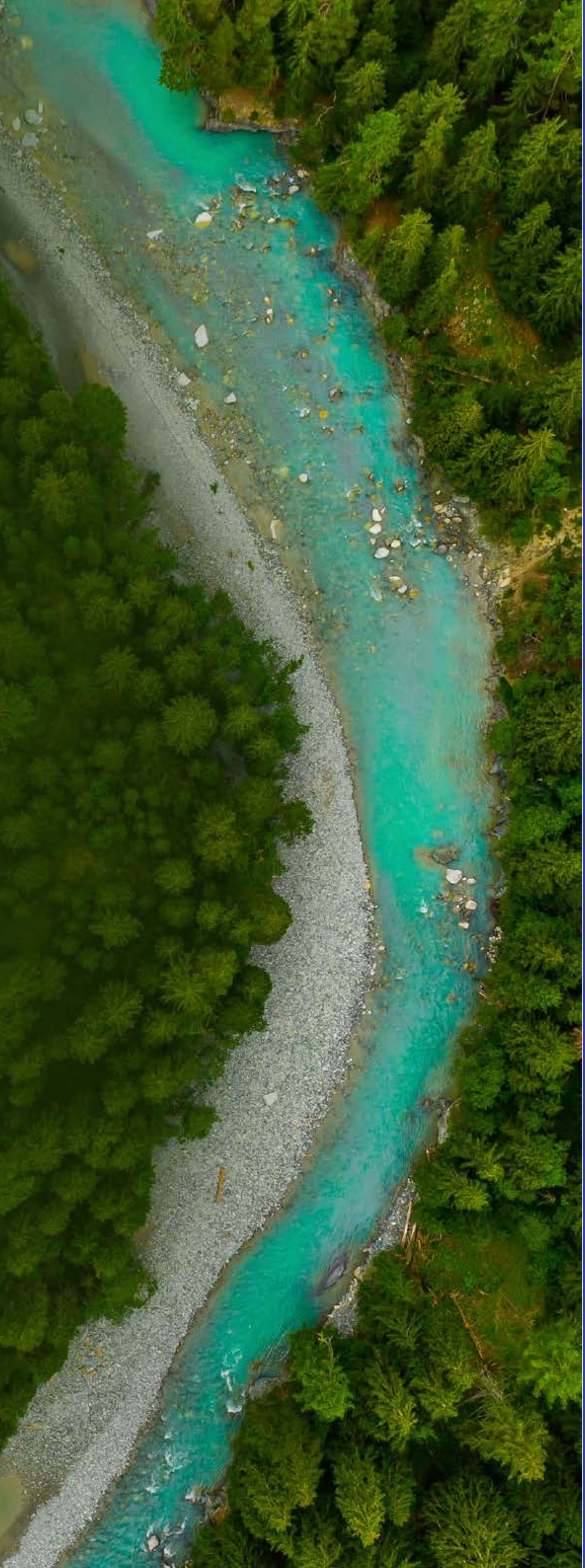
Apart from industry consolidation, we identify six major themes/deal drivers that have the potential to ignite investor appetite and keep global banking deals buoyant in 2021. These include:

- **Digital engagements —** digitally engaged clients could limit the value of branches
- **Low profitability —** organic capital generation is too low
- **Liquidity surplus —** deposits and credit on divergent paths challenging earnings
- **Sustainable finance —** towards portfolio transitioning
- **Asset quality —** more defaults to materialize in 2021
- **Regulations —** M&A under consideration.

Click to read further.

05

The outlook for banking deal activity remains optimistic for 2021. Fifty-eight percent of key markets expect deal volume to increase while 42 percent expect stable deal activity compared to 2020. Click to read further.



Banking M&A regional performance | 2020

Low valuations create buyers' market for cash-rich private capital players

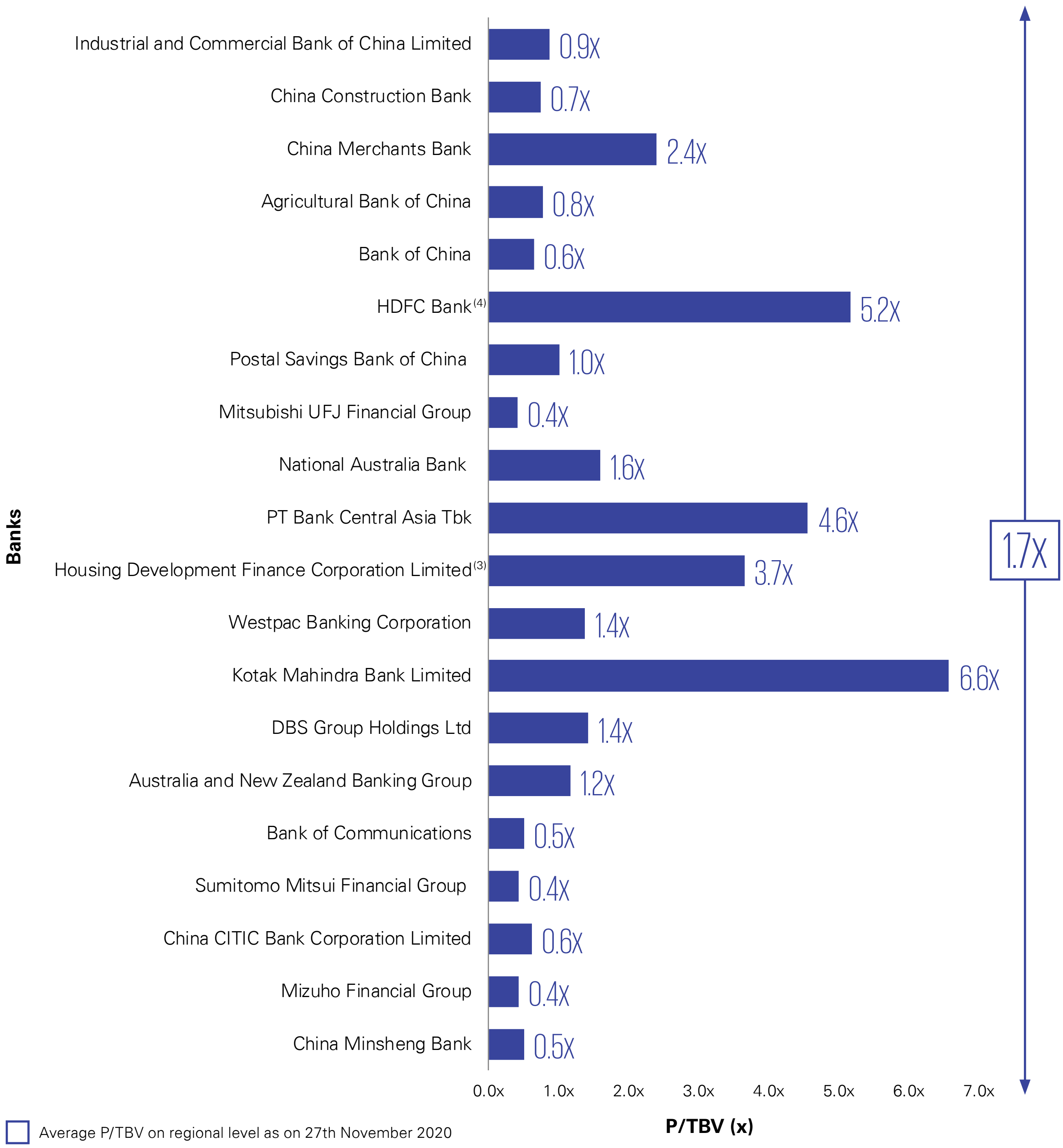
The impact and severity of COVID-19 remains unclear. Immediate measures taken by regulators globally have eased restrictions on liquidity and capital, however, revisions to loan loss provisions, maintenance of capital adequacy ratio and compressed net interest margins are just some of the immediate pressures confronting banks. Consequently, bank valuations dropped globally. At a regional level, North American and ASPAC banks are still trading at P/TBV equal to an average of 1.8x respectively while European banks are currently trading at significant discount levels with average P/TBV at 0.8x as of November 2020.

COVID-19 did create uncertainty in the deal making market whilst buyers and sellers considered the impact on strategy and pricing. Some buyers chose to focus on shoring up internal operations while others-built scale to acquire distressed portfolios, pumped up deals. Going forward, we expect private equity will lead the way. More than 1.5 trillion US dollars (USD) in dry powder remains and surplus cash may lead to stiffer competition and higher valuations in 2021.

P/TBV multiple (x) of the top banks, by region

ASPAC banks | Looking at the ASPAC region, Indian banks hold sound valuation levels, trading at an average of 5.1x, followed by Australian (1.6x) and Chinese banks (0.9x), as of November 2020. Banks in the region generally are well-capitalized. Asian banks have been preserving capital by pruning dividends or offering scrip options during COVID-19, allowing them to raise debt from yield-starved investors and further increase capital.

Figure 1 | P/TBV[1] of ASPAC banks[2]



Notes:

(1) The price to tangible book value (P/TBV) is a valuation ratio expressing the price of a security compared to its hard, or tangible, book value as reported in the company's balance sheet. The tangible book value number is equal to the company's total book value less than the value of any intangible assets.

(2) Top banks based on market capitalization

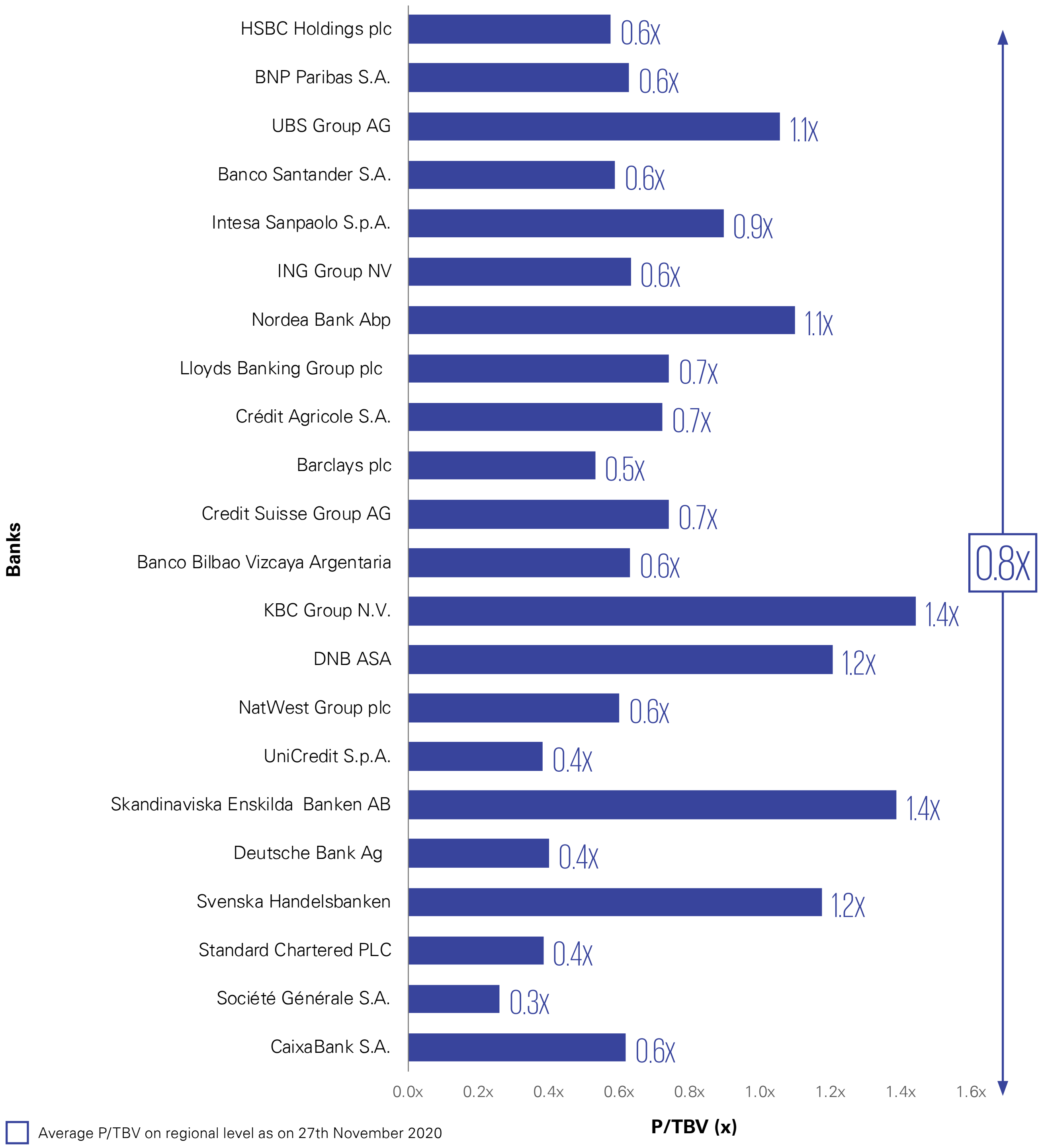
(3) Housing Development Finance Corporation Limited (HDFC) founded in 1977, is a financial services company specialized in mortgage and based in Mumbai, India. ISIN: INE001A01036

(4) HDFC Bank Limited, founded in 1994 is an Indian banking and financial services company headquartered in Mumbai, Maharashtra. ISIN: INE040A01034

Source: Bloomberg, KPMG analysis | Data extracted as on 27th November 2020

European banks | European banks valuations remain dampened. Looking at the Europe region, top Nordic banks (especially from Sweden, Finland) have stronger valuations (average 1.2x implied P/TBV) compared to other players in major economies like the UK, Spain, France, Italy and Germany. Capital and risk positions continue to be key rating strengths for Nordic banks.

Figure 2 | P/TBV[5] of European banks[6]



Notes:

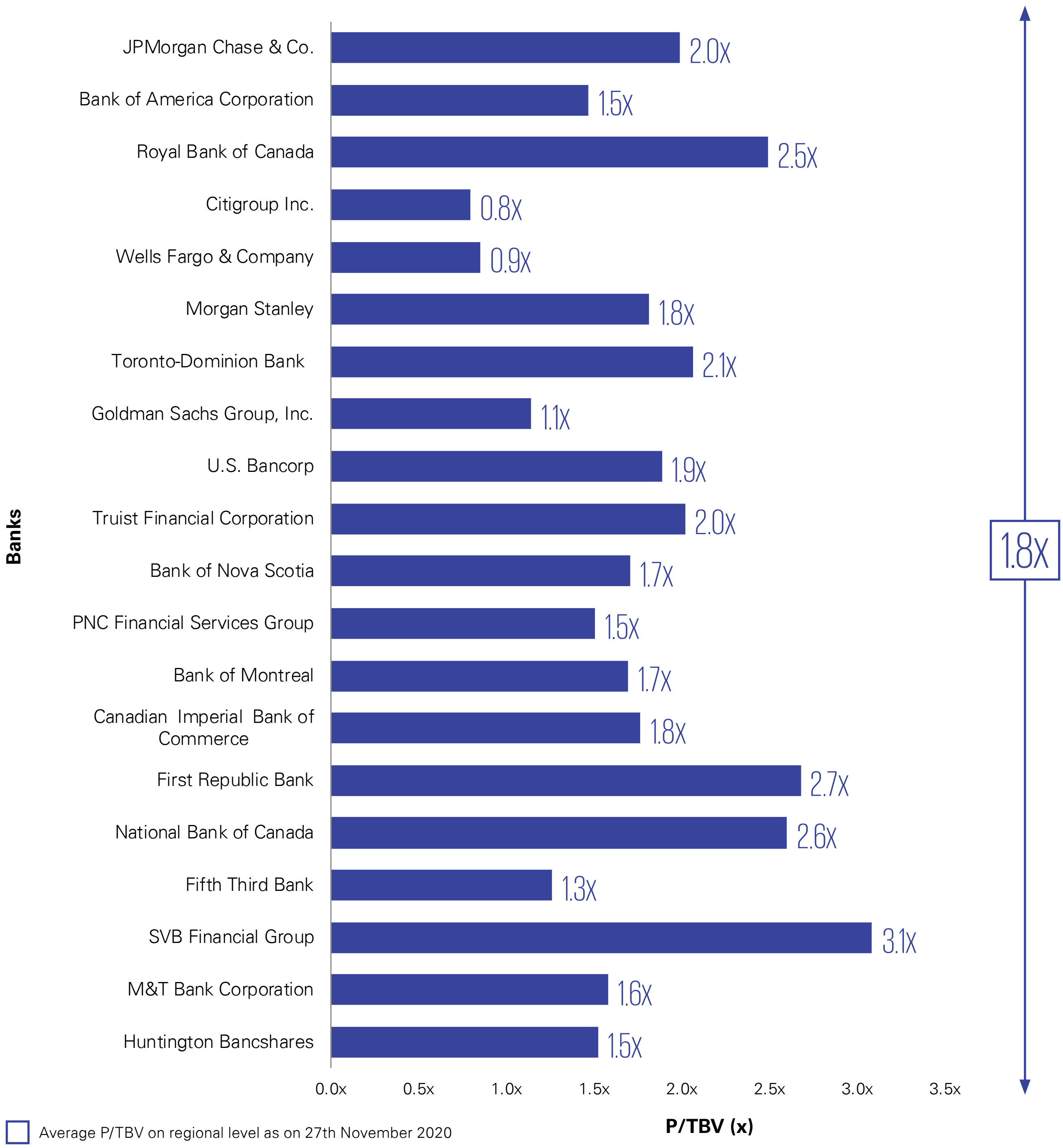
(5) The price to tangible book value (P/TBV) is a valuation ratio expressing the price of a security compared to its hard, or tangible, book value as reported in the company's balance sheet. The tangible book value number is equal to the company's total book value less than the value of any intangible assets.

(6) Top banks based on market capitalization

Source: Bloomberg, KPMG analysis | Data extracted as on 27th November 2020

North American banks | Top Canadian banks are trading at better P/TBV, at an average of 2.1x, compared to top US banks (average 1.7x), as of November 2020. In Canada, government relief efforts and loan deferrals by banks curbed an anticipated surge in delinquencies and impairments, with a simultaneous check on consumer-credit deterioration. Canadian banks are well capitalized, with a capital position well above regulatory requirements. The regulator has imposed a freeze on dividend increases and share buy-back programs. Going forward, however, top-line growth will remain a strong headwind, and, cost control and efficiency will play a key role in determining performance.

Figure 3 | P/TBV[7] of North American Banks[8]



Notes:

(7) The price to tangible book value (P/TBV) is a valuation ratio expressing the price of a security compared to its hard, or tangible, book value as reported in the company's balance sheet. The tangible book value number is equal to the company's total book value less than the value of any intangible assets.

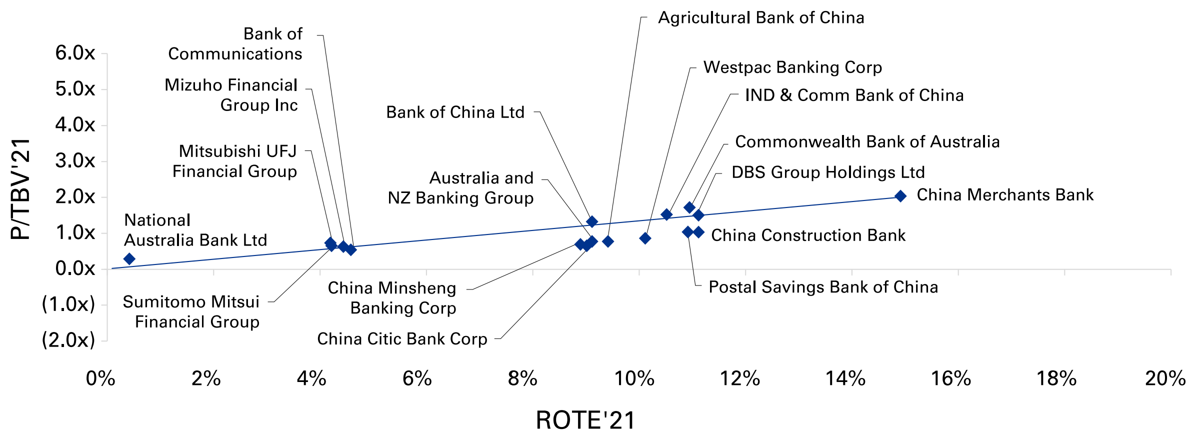
(8) Top banks based on market capitalization

Source: Bloomberg, KPMG analysis | Data extracted as on 27th November 2020

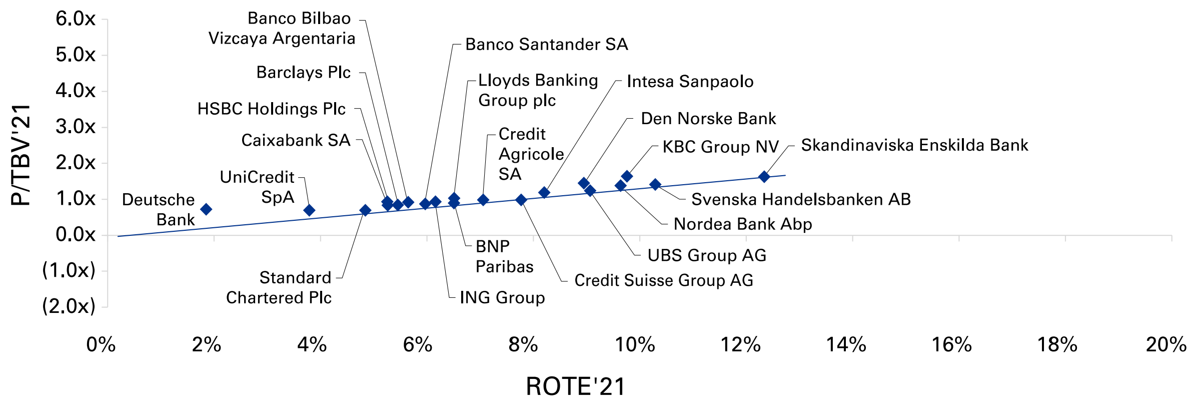
A strong correlation between bank valuation and profitability is envisaged by the regression analysis. North American banks register higher valuations due to higher expected profitability (ROTE equal to 12.3 percent on average, compared to 8.5 percent and 7 percent in Asian and European banks, respectively). Higher profitability can also be partially explained by the different business model, with Investment Banking predominating in the US versus Commercial Banking in the EU. European banks are showing expected profitability lower than the cost of capital with ROTE equal to 7 percent compared to a cost of equity equal to 8-10 percent on average.

Figure 4 | Regression ROTE'21 — P/TBV[9][10]

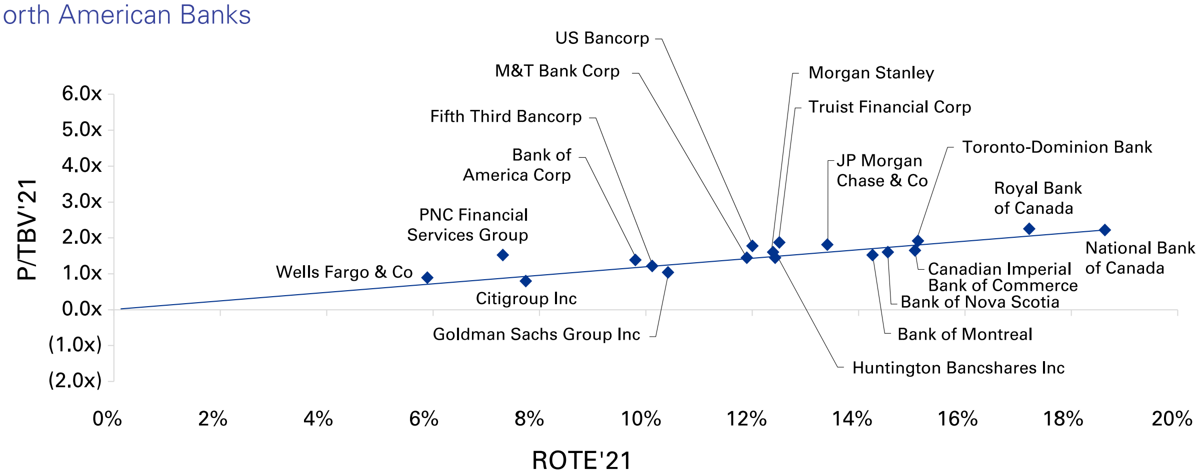
ASPAC Banks



European Banks



North American Banks



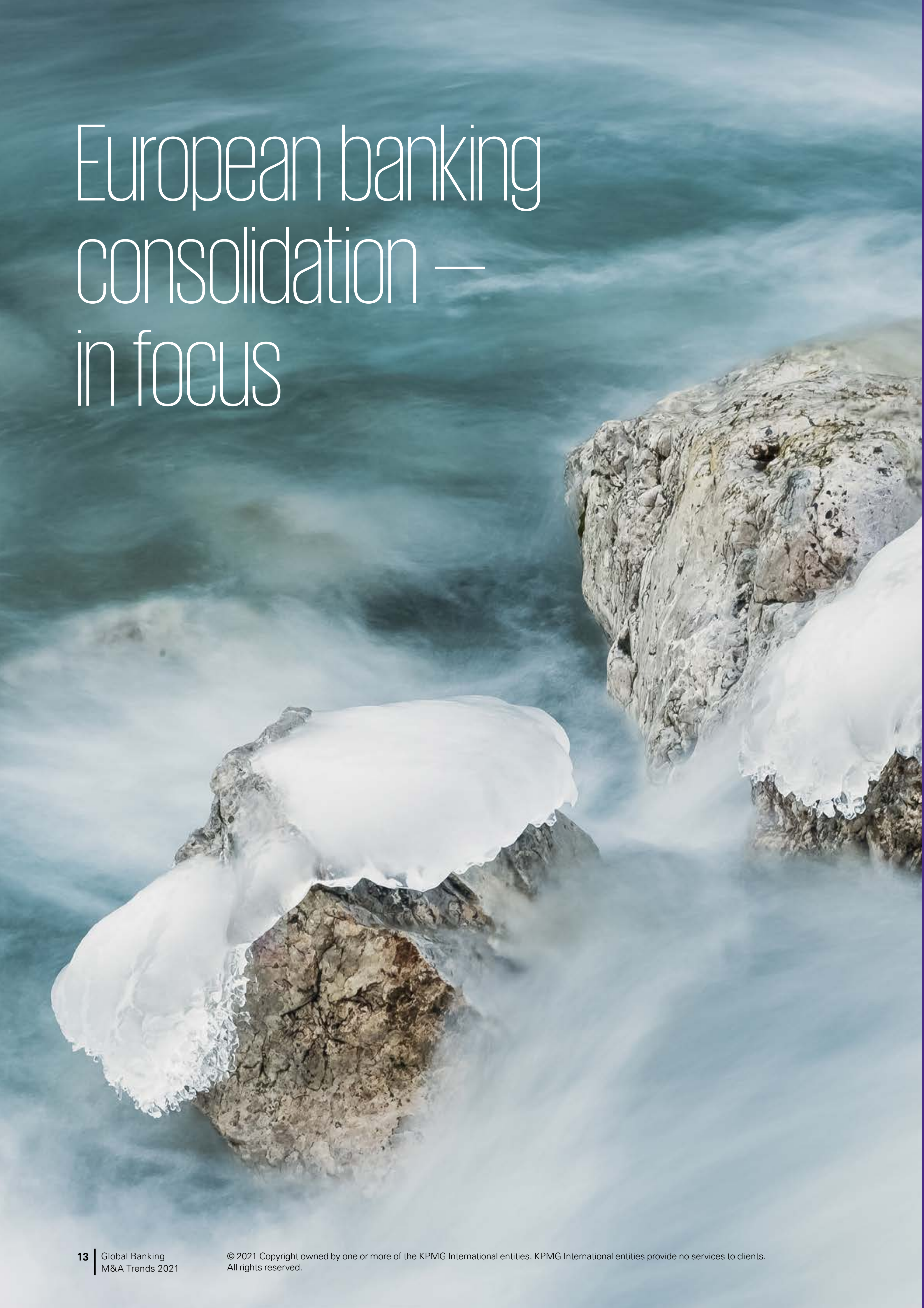
Notes:

(9) ROTE: Return on tangible equity (a version of ROE) is defined as net profit as a percentage of tangible equity (usually average tangible equity). Tangible equity is the equity value (or net assets) less intangible assets such as goodwill.

(10) For regression analysis, we have removed the outliers

Source: Bloomberg, KPMG analysis | Data extracted as on 27th November 2020

European banking consolidation — in focus



European banks seek firmer footing with M&A

Limited progress on cost take out measures has caused European banks to lose ground to their North American and Asian peers of late.

The market cap of the top five European banks is only ~ 274bn euros (EUR) versus ~EUR815bn for North American and ~ EUR802bn for ASPAC banks. In terms of profitability, European banks also lag and are expected to generate an average ROTE of 6.7 percent, compared to 12.2 percent North American and 9.9 percent for ASPAC banks for 2021E. Consequently, we continue to see low market valuations for many European lenders with many being substantially impacted by the pandemic. The biggest impact, however, has come from a spike in loan loss provisions and an ensuing reduction in post-tax profits.

Within this context, domestic scale becomes a critical lever for reducing the number of bank branches and improving profitability. Domestic deals will continue to take precedence while in-market transactions will also be more viable. We see this with a few larger-scale deals going through this year, notably Intesa Sanpaolo acquired UBI Banca, the third largest bank in Italy, and CaixaBank merging with Bankia in Spain. Banco BPM is evaluating potential consolidation activities within the domestic space, while rumors persist about a potential merger between UBS and Credit Suisse. However, cross-border transactions may still take time to pick up pace — hindered by difficulties finding necessary synergies and structural impediments.

Looking at broader trends, the ECB has revived the M&A debate after publishing a draft guide to banking sector consolidation in July 2020. The comments are a potential framework to address longstanding issues in the European banking sector (namely profitability and overcapacity). The ECB has outlined expectations on three important areas in relation to sector consolidation: the setting of capital requirements and guidance, the treatment of badwill and the use of internal models by new entities.

Figure 5 | Key drivers for European banking consolidation

ECB Guidelines

ECB is **encouraging consolidation** in order to address longstanding issues in the European banking sector, such as **low profitability and overcapacity**

ECB recently outlined **the principles** underpinning the **prudential supervisory approach** when analyzing the potential business combinations

Badwill recognition

Recognition of the accounting value of badwill to increase the sustainability of the business model of the combined entity, for example by **increasing the provisioning for non-performing loans** and to **cover transaction or integration costs**

Cost reduction and efficiency improvement

Potential cost synergies in terms of personnel and branches rationalization

NPLs derisking and capital adequacy

Potential NPLs de-risking transactions, also in light of recent ECB's calendar provisioning guidelines

Capital consumption due to loan losses and difficulty to raise capital

Low interest rates

Rock-bottom interest rates (also following COVID-19 pandemic) keep impacting bank's profitability

Significant tech investments

The world of technologies applied to banking is rapidly growing in the industry

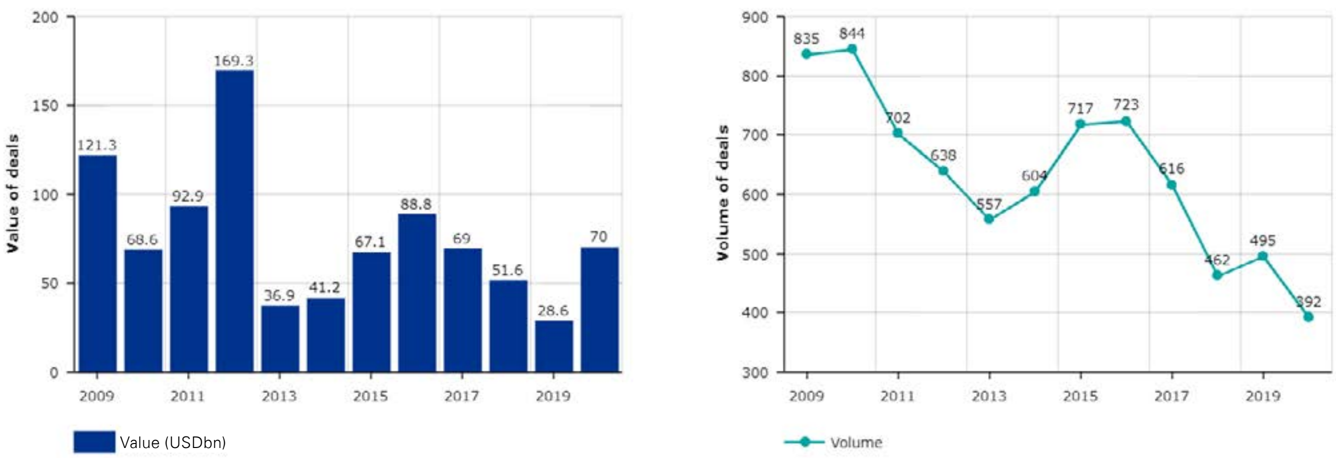
Keeping up with FinTech and IT investments is harder for smaller banks

Source: KPMG analysis

European banking consolidation (contd).

Figure 6 | European Bank M&A has reduced over 2009-2020

Globally, few big-ticket deals kept the M&A market bubbling in 2019 and 2020 especially in core banking, with adjacent or aligned sectors such as payments, specialty finance and software companies servicing financial institutions, supported by underlying growth drivers, low cost funding and strategic motivation. Despite a formidable list of challenges faced by the European banks — the value and volume of mergers and acquisitions involving European banks fell to its lowest level since the global financial crisis. The drive to consolidate (from a supervisory perspective) is a logical conclusion to remedy some issues that the ECB has seen over a long period in the Eurozone banking market.

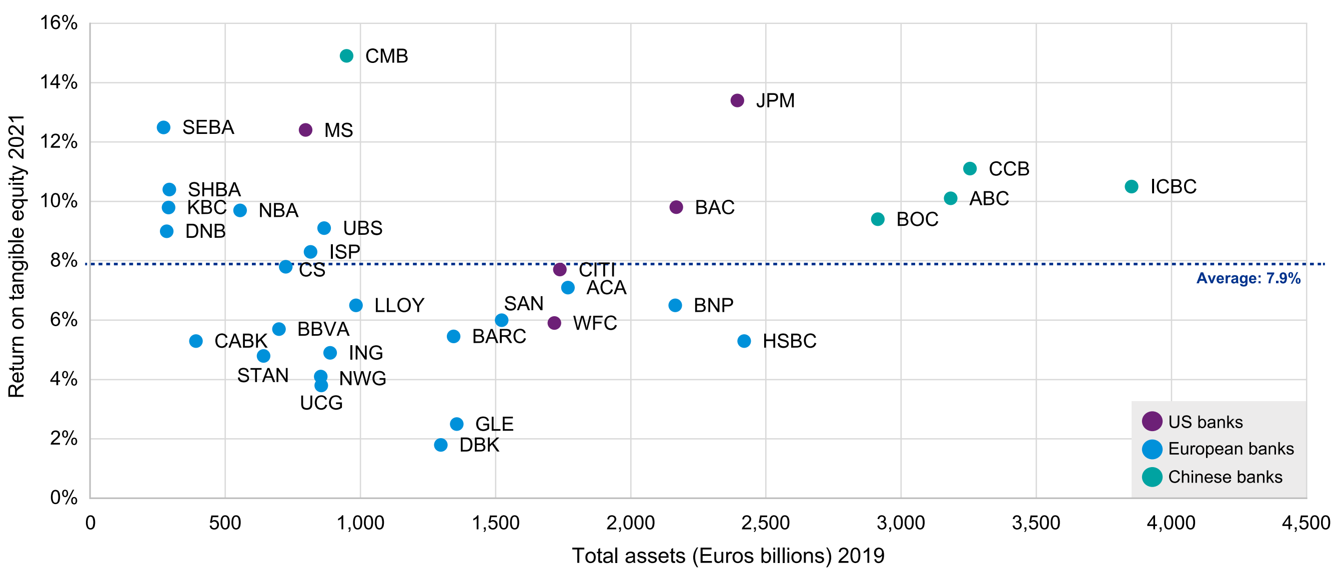


Source: ThomsonOne

Figure 7 | Scale alone may not drive profitability

Compared to selected institutions, we observe that European banks are not only smaller based on asset size than US and Chinese banks, they are also less profitable. Chinese banks and large US institutions are expected to generate a return on tangible equity above industry average of 7.9 percent for 2021E, while European institutions are still at a much lower level. Thus, the scope of needed consolidation for European banks is much higher.

Moreover, within the region, large banks (assets > EUR1,500 bn) are generating lower returns compared to many mid-sized banks. Thus, it appears that 'scale' as an M&A driver alone may not revive European bank profitability. Factors such as margin considerations, NPLs, business model fit, scope for meaningful cost cuts and potential value creation may take priority.



Source: KPMG analysis, Bloomberg, Capital IQ

Significant badwill could trigger further European consolidation

The ECB has allowed banks to recognize an accounting gain known as negative goodwill, or badwill, where the target is trading below 1x P/TBV and P/CET1 (acquiring bank below tangible book value, or at a lower price than the sum of its assets minus liabilities).

While most European banks are valued below accounting book value, M&A is probably going to involve some form of negative goodwill. The regulator highlighted an expectation that badwill will be used to increase the sustainability of the combined entity's business model (i.e. used in impairments and coverage at the time of the integration) and not put towards shareholder remuneration.

This appears to be a positive step for M&A activity as it recognizes the value of badwill as capital. Computation criteria remains unclear, however, especially for large deals. We expect this to accelerate consolidation among banks, particularly mid-sized banks. Some players may pursue a 'wait and watch' strategy until mid-2021 when institutions are able to evaluate NPLs resulting from COVID-19. Moreover, we expect badwill to act as a catalyst for domestic mergers rather than near-term cross-border transactions.

Figure 8 | Significant badwill could trigger further European consolidation

Bank	Country	Exchange rate	Currency	Market cap (EURbn)	Implied Badwill (EURbn)	P/E'21	P/TBV Last	ROTE'21
HSBC Holdings PLC		1.14	GBP	91.8	92.0	12.7x	0.6x	5.3%
BNP Paribas		—	EUR	54.8	44.0	9.2x	0.6x	6.5%
UBS Group AG		0.90	CHF	46.9	3.4	10.8x	1.1x	9.1%
Banco Santander SA		—	EUR	42.7	57.4	9.8x	0.6x	6.0%
Intesa Sanpaolo		—	EUR	37.8	13.6	10.5x	0.9x	8.3%
ING Groep NV		—	EUR	32.8	20.9	9.8x	0.6x	6.2%
Nordea Bank Abp		—	EUR	29.7	1.0	10.9x	1.1x	9.7%
Lloyds Banking Group PLC		1.14	GBP	29.4	17.4	11.0x	0.7x	6.5%
Credit Agricole SA		—	EUR	28.5	29.3	10.4x	0.7x	7.1%
Barclays PLC		1.14	GBp	27.0	33.5	9.7x	0.5x	5.5%
Credit Suisse Group AG		0.90	CHF	26.5	13.5	8.6x	0.7x	7.8%
Banco Bilbao Vizcaya Argenta		—	EUR	26.4	22.3	10.9x	0.6x	5.7%
KBC Group NV		—	EUR	24.9	(6.0)	14.4x	1.4x	9.8%
DNB ASA		0.10	NOK	24.0	(3.9)	12.8x	1.2x	9.0%
Natwest Group PLC		1.14	GBP	21.7	22.3	17.1x	0.6x	4.1%
Unicredit S.p.A		—	EUR	20.3	35.5	11.0x	0.4x	3.8%
Skandinaviska Enskilda Banken AB		0.09	SEK	20.2	(4.7)	10.9x	1.4x	12.5%
Deutsche Bank AG		—	EUR	19.6	36.3	23.7x	0.4x	1.8%
Svenska Handelsbanken AB		0.09	SEK	17.2	(1.4)	10.8x	1.2x	10.4%
Standard Chartered PLC		1.14	GBP	16.3	32.7	10.1x	0.4x	4.8%
Societe Generale SA		—	EUR	14.8	48.7	10.8x	0.3x	2.5%
Caixabank SA		—	EUR	13.2	11.9	12.0x	0.6x	5.3%
					Average	**11.7x**	**0.8x**	**6.7%**

Top 5: EUR274 bn

Top 10: EUR421 bn

Source: Bloomberg, KPMG analysis | Data extracted as on 27th November 2020

What to expect in the year ahead?

Challenges remain in 2021. The recessionary environment will weigh on bank loan demand while ever-increasing pressure on margins, default rates and NPL ratios may generate a sharp increase in non-performing loans which could severely impact some EU countries. M&A has been the obvious option for several years for the European banking industry. But with the ECB's more relaxed tone, we expect in-market M&A to benefit from significant badwill being used to absorb upfront restructuring costs and additional provisions. Also, expect to see more consolidation among banks, mainly in over-banked markets like Spain, Italy and Germany.

Deal activity will be driven not only by scale issues but also by synergies, geographical and product diversification, strategic business fit and potential value creation. We see large deals already happening, but these M&A transactions may lead to even larger complications if external challenges like digitalization are not prioritized following the pandemic. For banks to benefit from consolidation, they must invest in relevant technological areas.

Cross-border transactions will take time, with the need to deliver credible synergies, accommodate regulatory constraints and navigate accounting headwinds.

Major M&A themes and impact for 2021

At a global level, global banking consolidation theme would remain, we also expect other integrals drivers of digitalization, low profitability concerns, push towards sustainable finance, challenged earnings, asset quality issues and regulatory intervention to reshape the banking deal landscape in 2021. Though all themes may not be prevalent for all geographies, however, they may be potential topics of discussion in board rooms of many banks.

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Methodology

Digitally engaged clients could limit the value of branches

A critical driver for deal activity in 2021 will be heightened digital engagement with customers decreasing the need for physical branches. Globally, banks are likely to place more capital investment in buying new technology and digitization.

— As per a report by Kearney, 25 percent or 40,000 bank branches will close across Europe in the next three years as the COVID-19 pandemic drives the uptake of digital banking.(1)

— A leading German bank announced in September 2020, the closure of 100 branches in domestic market — optimizing domestic distribution channels and adapting to the new ways in which customers are interacting with the bank.(2)

Potential impact

Better valuation multiples of digital-savvy banks compared to traditional incumbents is another force driving digital engagements, forcing banks to infuse digital into their M&A strategy. The next wave of bank consolidation has already set-in especially in Europe. We expect progressive banks to focus on acquiring digital capabilities like AI and advanced analytics. to improve their target screening process, build interactive customer experience dashboards and deploy digital HR capabilities to improve workforce integration processes

Low profitability – organic capital generation is too low

Another key driver is the ability to generate organic capital while managing overall share count. In response to COVID-19, capital preservation has become critical and profit retention alone may not be enough. With increased impairments and even with cessation of dividend payments, it would be a challenge for banks to restore their capital ratio targets amid the prevailing uncertainty.

Potential impact

This would pave the way for banks to explore other radical options such as asset and liability restructuring, new capital issuance, and the sale or closure of portfolios and businesses which may accelerate deal activity in 2021.

Deposits and credit on divergent paths challenging earnings

Banks are in better shape in terms of capital and liquidity than during the global financial crisis. But earnings remain an on-going concern. Most global banks are seeing deposits flooding in the absence of loan demand (low consumer spending and utilization from small businesses); a lack of attractive yield opportunities will continue to put pressure on net interest margins.(3)

— As per the ECB total deposits held by Eurozone banks rose 10.3 percent(4) in the year to July 2020 (climbing above EUR12 trillion). According to FDIC data, USD2 trillion(5) surge was seen in deposit accounts of US banks since January 2020.

The governments of various countries also unleashed funds to bolster small businesses and individuals via stimulus packages and unemployment benefits such as the MSME guarantee program and the unlimited bond-buying program.

Potential impact

Surplus liquidity is weighing on margins and forcing several banking institutions to pursue deals to help drive higher earnings.

— Banks are also scaling back from leveraged loan exposure as credit risk tied to them remains elevated.

— Many banks have increased their loan loss provisions but the actual impact of COVID-19 on corporate and consumer lending is still largely unknown.

This all in-turn could encourage many bank boards to include M&A in future strategic actions as they struggle to grow earnings.

Notes:
(1) https://www.businessinsider.com/
(2) https://nsbanking.com/
(3) https://www.spglobal.com/
~~(4) https://www.cnbc.com/~~
~~(5) https://www.ft.com/~~

Sustainable finance — towards portfolio transitioning[6][7]

Global banks are increasingly embedding environmental, social and governance (ESG) into their risk-management frameworks. As the M&A landscape starts to normalize, we expect sustainability-related M&A to open new potential revenue opportunities for the banking sector. As noted by the ECB[8], exposure of European banks toward corporates with non-ESG models (particularly in sectors such as real estate, transport and brown sectors) broadly range from 5 to 10 percent, implying that lending is not concentrated in sectors which are vulnerable to climate risk.

Potential impact

Banks are likely to substitute existing business portfolios, though such portfolio transitions might take long especially for those heavily reliant on environmentally unfriendly sectors like mining. Longer term, the trend is expected to drive a 3-4 percent incremental ROE difference. Banks with asset management units can also see a substantial increase in sustainably managed assets over the next five years. It may not bring a major change in fees but would attract net new money. Climate risk-related disclosure by banks could also be a potential catalyst for further change.

Asset Quality — early signs of deterioration; more defaults in 2021

Europe: Asset quality deterioration showed early signs; however, a significant impact has not emerged thanks to the loan moratoria, furlough schemes and other state support, in European markets. Despite COVID-19, investor fund-raising activity has not slowed. Due to unprecedented intervention by authorities and governments, ultimate transaction activity may decline but valuations may not fall as fast or as far as in previous crises.

Asia Pacific: Several measures have been undertaken such as liquidity injections, special loans to affected industries and regions, and policy rate cuts by Asia- Pacific governments, central banks, and supervisory authorities to address the ramifications of COVID-19, including support for banks to provide forbearance. We estimate that Asia-Pacific in 2021 will be hit with additional nonperforming assets.

Potential impact

— France, Spain, Greece, Italy and Cyprus are expected to see an increase in NPL-related deal activity, but, in all countries, it will be harder to spot the mega-deals of past years.

— Buyout fundraising in the region will be stronger than many expected. Investors appear positive about future returns in anticipation of pricing adjustments.

— For 2021, we expect an increase in sub- performing markets (UTPs in Italy) and the secondary market, while secured NPLs are facing a slowdown in the next few months.

— In China, with most listed banks compliant with regulatory requirements and their CET1 ratios stable over the past few years, we expect such banks to withstand the risks as well as provision levels arising out of COVID-19. These banks have boosted their loan-loss provisions throughout the year as the authorities urged them to step up their efforts in lending to troubled sectors. Banks have also allowed specific borrowers to delay interest and principal payments to March 2021. As the Chinese economy is staging a rebound, we expect banks' bad loan ratio to stabilize in the next two quarters considering moratorium from the lender's side and improved liquidity from the borrower's side, but loans overdue may increase in 2Q21 when the payment holiday expires. Foreign distressed debt investors, often called vulture funds or special situations funds, are likely to tap this opportunity. Other markets which are expected to see large volumes of NPLs and a surge in deal activity are those found in development countries such as India, Indonesia, and Thailand etc. where they have more sector concentration such as tourism.

Notes:
(6) https://www.abladvisor.com/
(7) https://www.americanbanker.com/
(8) https://www.bankingsupervision.europa.eu/

Regulations — M&A under consideration

— In the US, the Justice Department reconsidering its antitrust review process[9] (revamping the 1995 Bank Merger Guidelines) provides an impetus to more M&A activity among community banks.

— In July 2020, the ECB[10] launched a new supervisory approach to promote further bank consolidation. The guidelines largely focus on the use of supervisory tools to facilitate sustainable consolidation projects and recognition of badwill to increase sustainability of business models.

— Governments in several ASEAN countries such as Indonesia, Vietnam, and Myanmar are focusing on liberalizing and increasing foreign participation in their respective countries.

Potential impact

— In the US, revamping of merger guidelines is expected to benefit small and mid-size bank M&A deals by identifying transactions that are likely to decrease competition and create a post-merger monopoly.

— In Europe, the consolidation wave is expected to strengthen. Some of the largest banks are currently discussing potential mergers while big deals are happening.

— In Myanmar, foreign banks anticipate being able to secure a license to engage in onshore retail business through a subsidiary or joint venture. In Thailand, commercial and representative bank offices were removed from the list of restricted businesses needing a foreign business license.

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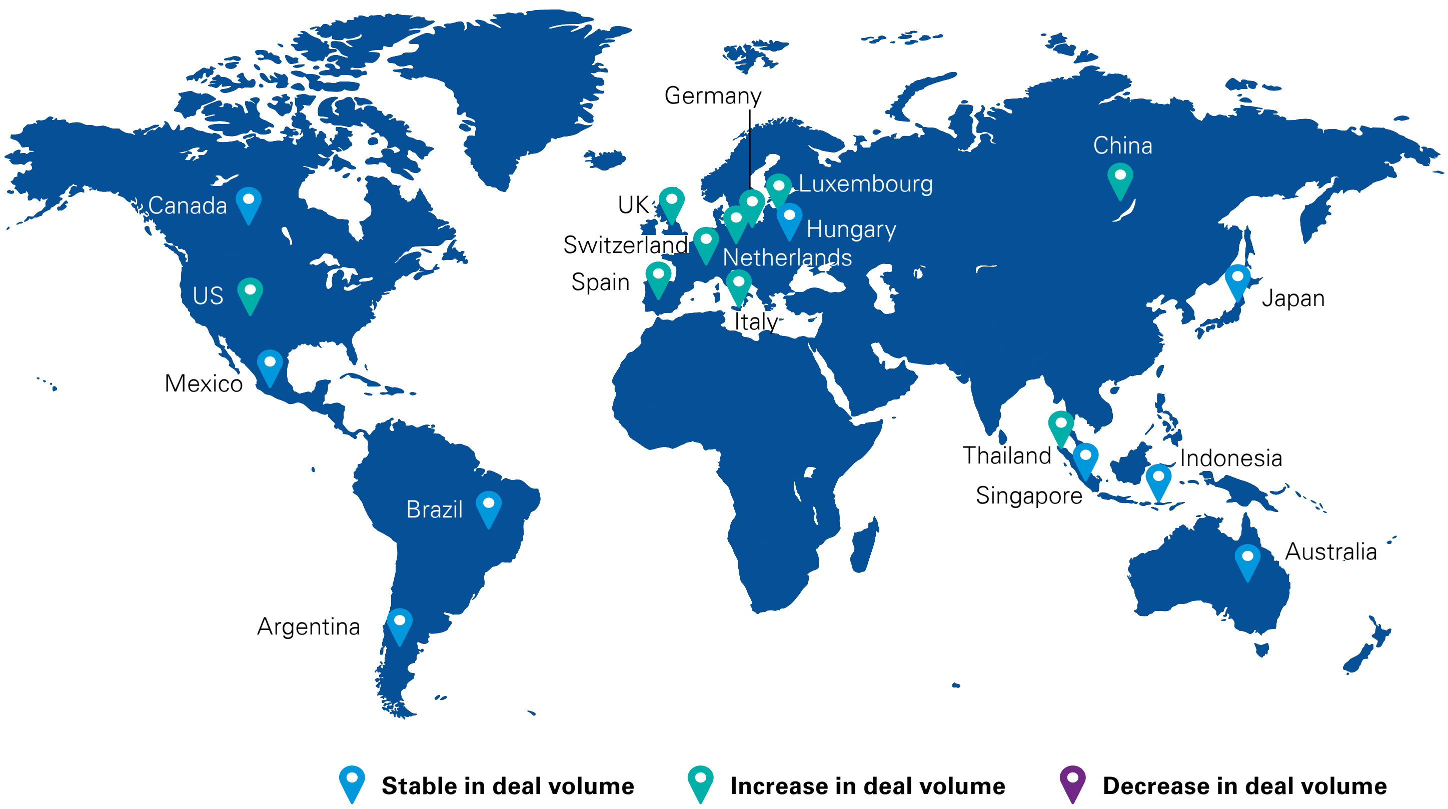
(9) https://news.bloomberglaw.com
(10) https://www.cnbc.com/

Banking M&A insights: country outlook

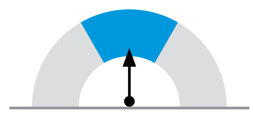
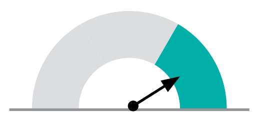
A wide dispersion in economic recovery is expected across countries in 2021, as we move from the first quarter into the second, supported by continued monetary and fiscal support and vaccine rollouts. In this section, we offer perspectives on how different countries are estimating banking transaction market to perform in the coming months with specific view on PE participation. Additionally, our KPMG internal banking survey has presented optimistic results with 58 percent of key markets expecting deal volume to increase while 42 percent expect stable deal activity compared to 2020.



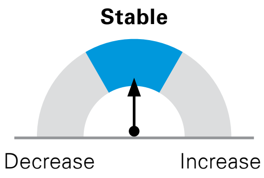
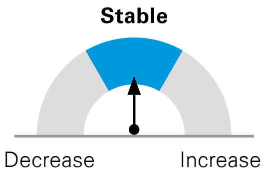
Source: KPMG internal survey

Banking M&A insights: country outlook

Asia Pacific

Country	PE interest	Deals 2020 vs 2021
Australia | In 2021, the regulatory simplification program driving divestment of banks' non-core financial services offerings such as fund management, financial planning, insurance and asset lending is expected to continue. Moreover, deals in pursuit of digital channels including fintech capability is another deal catalyst to watch. Opportunities remain for private equity and other foreign investors to position in the Australian market. Overall, we should see a continued robust transaction market for non-core banking operations over the next 12 months.	Likely focus to be on remaining fund management platforms, superannuation businesses and asset lending businesses.	
China | Overall, banking opportunities have risen as banks continue looking to increase their capital and some shareholders look to exit for different reasons. New opportunities to obtain a higher strategic stake in domestic banks given underperformance with NPLs and lack of capital, are seen. Such opportunities were rare earlier, and we expect them now to drive more domestic M&A. Consolidation may take place for city commercial banks and rural commercial banks. Such NPL disposal, Debt-Equity Swap as well as Capital Injection are possible and potential transactions to be seen under this consolidation context. In coming months, China will launch the ever-first time Retail NPL disposal on those consumer finance (credit cards) and unsecured personal loans. This Retail NPL will be on the primary market (Chinese Banks to Asset Management Company) without the involvement of secondary market in this pilot trial. Opening China's financial services market will also continue to attract foreign investors. Besides direct equity investments, we expect to see strategic co-operation between Chinese banks and foreign investors, particularly around wealth management, digital banking and Fintech.	Traditionally, PE has not been active in banking due to regulatory reasons. We expect this to continue. However, PE is expected to remain active in other sub-sectors, such as payments, leasing and consumer finance.	

Asia Pacific

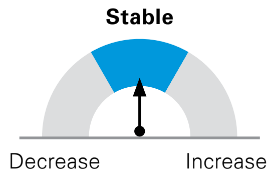
Country	PE interest	Deals 2020 vs 2021
Indonesia | Overall, Indonesia remains a popular market for foreign investment and banking M&A amid the high profitability of local banks, the large unbanked population and government efforts to consolidate the industry. From 2019, we saw an increase in foreign acquisitions following a shift in OJK to be more accommodating to foreigners, where OJK relaxed its 40-percent stake cap for new investors willing to do additional mergers after acquisitions. With COVID-19, M&A transactions in all financial sectors slowed in 2020 but are expected to pick up in the medium to longer-term (deal activity has already started returning to pre-COVID levels). OJK has also announced a mandatory increase in core capital requirements for commercial banks to IDR3 trillion by the end of December 2022. This is primarily aimed at reducing the number of small banks, which are highly vulnerable to financial stress and to create a strong banking system, expand the business scale and increase competitiveness through innovation and enhance the national economy. There is a rapid move towards cashless payments, given the quick adoption and large penetration of smartphones and growth in ecommerce. These will further drive bank and non-bank M&A for traditional lending and payments providers (bank networks, ATM networks and Fintech entrants).	Attractive destination for domestic and foreign PE firms. Non-performing Loans (NPL) will remain a key segment of interest.	
Japan | We expect several regional bank consolidation deals, prompted by new government measures as well as inherently low profitability and growth amid ultra-low interest rates and shrinking regional economies due to population decline. The new administration that started in September 2020 continues to encourage consolidation of regional banks. There have been or will be several measures to facilitate consolidation, such as the introduction of an exception in applying antitrust legislation, subsidies for integration costs, and the application of additional interest rates on central bank deposits for merging or consolidating banks. However, many bank CEOs have expressed discomfort over the government applying consolidation pressure. In 2020, we saw several consolidation deals between leasing companies. We expect this trend to continue. Further consolidation and alliances are expected between domestic leasing companies in order to strengthen financial bases for taking more risks for growth area and/or to combine business strengths of non-financial companies and those of leasing companies. Moreover, overseas investments by banks and leasing companies (mainly in banks and non-bank financial institutions) will continue, especially in Asia.	PE is not expected to remain active within the sector.	

Asia Pacific

Country | PE interest | Deals 2020 vs 2021

Singapore | Following COVID-19, banks will need to maintain their regulatory capital and other liquidity requirements. However, this will be challenging if IFRS 9 requires an increase in provisioning from an upgrade in expected losses or regulatory capital buffers change. Heightened unemployment and future cash flow risks may impact the serviceability of residential property loans, SME loans and unsecured loans across a number of sectors, particularly travel, hospitality, retail, entertainment, real estate and construction. The MAS and banks were supporting customers through the Special Financial Relief Program (SFRP) allowing deferred repayments of loans until 31 December 2020. The support measures were subsequently extended to help individuals and SMEs facing cashflow difficulties transition gradually to full loan repayments and support progressively expire during 2021.Short-to medium-term liquidity risk will need to be stress-tested amid the impact of expected delinquencies increase following the SFRP moratorium. Advancements in Fintech and digitalization have paved way for digital banks in Singapore, with MAS granting two digital full bank licenses and two Digital Wholesale Bank (DWB) licenses, in a first for the city-state and a highly anticipated move that aims to liberalize the financial industry.

PE interest: PE activity in the sector will likely center on Fintech and payments opportunities, particularly given the growth of digital financial services offerings from non-banks such as technology companies, online platforms, e-wallet providers. The impacts of COVID-19 will also drive NPL activity as distressed credit opportunities emerge, underpinned by reducing government support and financial impacts of IFRS 9.

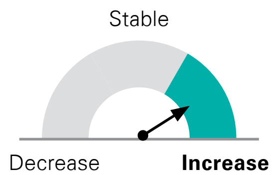


Thailand | ASEAN based deals have been a key theme for Thai banks with Bangkok Bank closing an approximately USD2.9bn deal in December 2020 to acquire Permata Bank of Indonesia among other smaller regional forays by Thai banks in consumer finance and banking. Thai banks remain active in the fintech/venture space with their venture arms closing funding transactions in the areas of e-payments, logistics and customer experience technologies, among others.

The banking regulator has provided certain dispensation from the application of IFRS 9 staging, and related expected loss recognition for loans under relief programs which will continue into 2021. The expected NPL trend is a key concern for market participants and regulators. We understand that regulators are discussing with stakeholders necessary measures and interventions.

NPLs and other operational pressures may drive further consolidation within the ranks of mid-tier banks. We are also seeing increasing M&A and funding activity in Thailand's Asset Management Company (AMC) space as local and foreign investors look to benefit from the expected increase in the supply of distressed assets, but these are very much concentrated in the areas of secured Retail and SME lending, and further significant distressed opportunities are likely to arise, particularly in the corporate sector. Thai banks remain keen on outbound deals with Vietnam often cited as a preferred destination within ASEAN.

PE interest: PE is not generally active within the banking sector but has invested to setup AMC platforms over the past few years. The scale of NPLs will likely reopen the field to foreign PE. Fintech, technology platforms and consumer finance are expected to be other key areas of PE interest.



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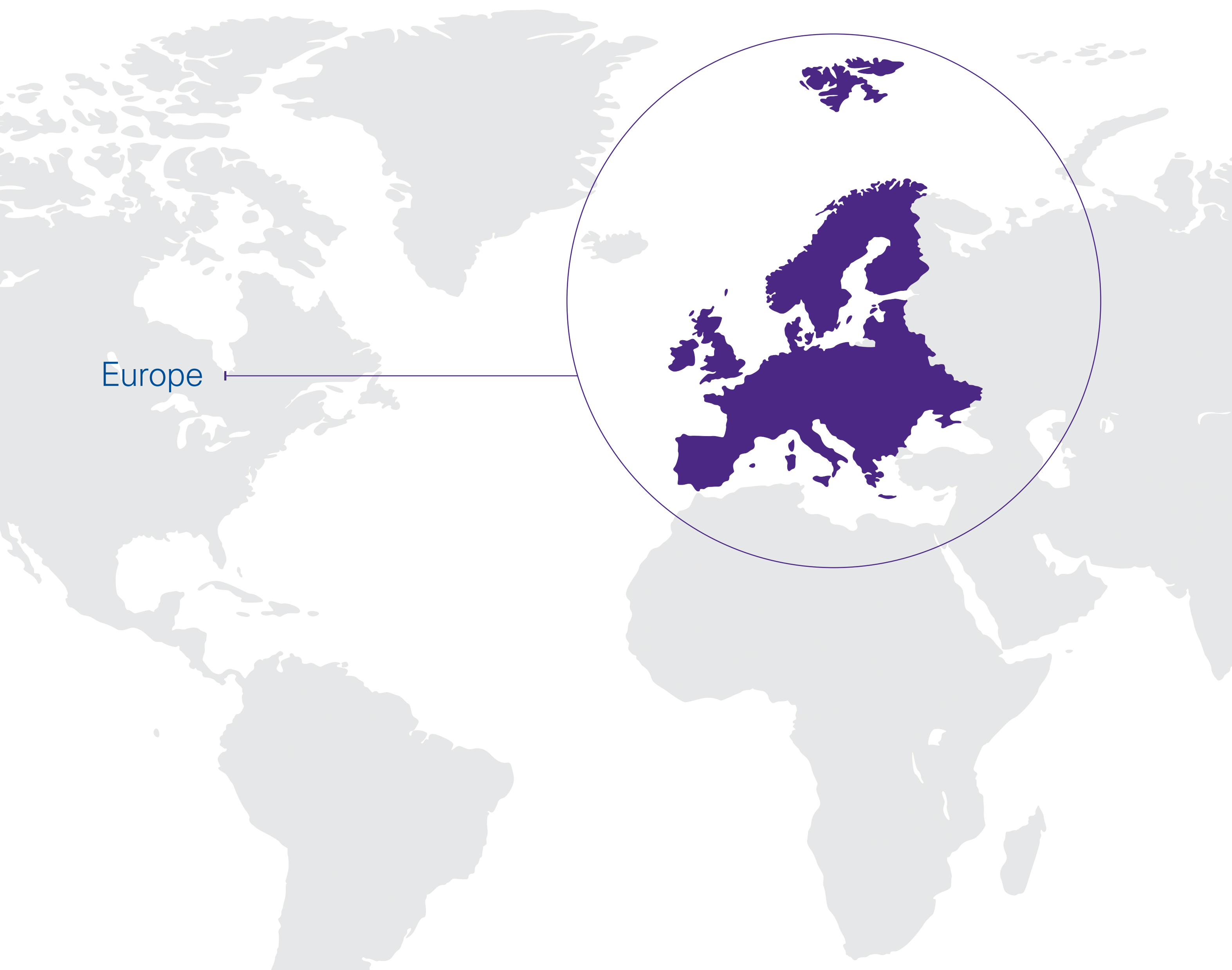


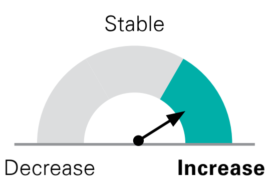
Country

Germany | Deal activity remained subdued until September 2020 amid COVID-19’s impact. Only larger long-term deals progressed while smaller deals were canceled or postponed. Deal activity picked up in September 2020, driven by postponed project flow and new projects starting after summer. Banking deals evolved into restructuring cases, where strategic buyers pursue badwill acquisition opportunities to increase equity positions or disposal of non-core assets. In 2021, banks will face three major challenges —low interest rates (low NII margins), higher loan loss ratios (pressure on CET1 levels) and strong disruption of distribution channels for new business production (closure of branches and poor digital distribution channels). The combination of headwinds and deal drivers is expected to accelerate deal activity as some banks may not survive this in the next 24 months.

PE interest

PE investors are looking across the board but prefer balance sheet light investments.

Deals 2020 vs 2021

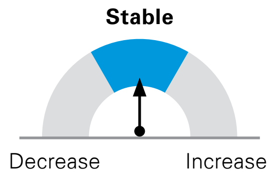


Europe

Country | **PE interest** | **Deals 2020 vs 2021**

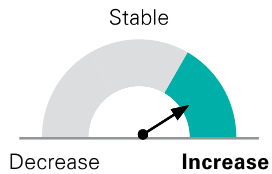
Hungary | In 2020, transactions came to a standstill. Buyers claimed they were unable to assess the impact of COVID-19 till mid-2021 while sellers were reluctant to sell at depressed prices. In 2021, banks could evaluate the damage caused by COVID-19 on balance sheets and consider if prices are right to sell/buy. In view of credit quality, banks have provisioned themselves adequately for NPLs, however, we expect NPL sales may resume but not before the impact of COVID-19 is clear. Most players see Fintech in the region as insignificant, having caused limited disruption to date. Several banks have also developed some payment solutions in-house.

PE has only been active very sporadically, mainly in turnaround situations in the Balkans and in the Baltics. PE plays a part in the NPL market which is consolidating rapidly but is taking a breather now.



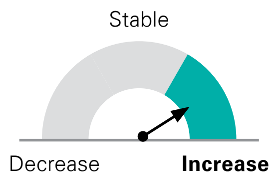
Italy | In 2020, Italy faced a new wave of domestic consolidation amid significant transactions, such as Intesa Sanpaolo and UBI Banca and the recently announced Credit Agricole public tender offer on a small-sized Italian bank located in Northern Italy, and other smaller transactions. In 2021, consolidation is expected to continue, mainly driven by cost optimization and NPL deleveraging. Some distressed opportunities might be at the center of potential acquisitions as well.

PE has not showed significant interest in the pure commercial banking sector, so the PE funds are more focused on NPLs, insurance and the specialty finance sector.



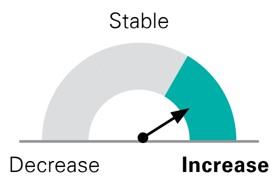
Luxembourg | European banking groups continue to reassess their Luxembourg private banking subsidiaries, when AuM fall short of the current minimum profitability threshold to operate, (EUR10bn). Margins are under pressure from new regulations, escalating compliance costs, digitization of platforms and low interest rates. With Brexit now a reality, Europe-based payment businesses are increasingly establishing a presence in Luxembourg. Banking subsidiaries that are subscale will continue coming to market in the years to come while sector consolidation will likely continue in private banking. We expect fintechs, regtechs and alliances with bigtechs to further reshape the banking landscape.

PE have had limited success to penetrate the Luxembourg banking market, as a result of regulatory hurdles.



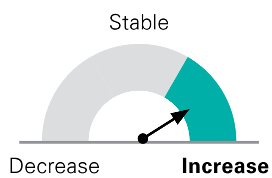
Netherlands | In general, we saw relatively limited deal activity in 2020, certainly due to COVID-19 which caused banks to reprioritize. For 2021, it is difficult to predict the level of bank deal activity, however, we are likely to see continued interest in Fintech and platform-related opportunities. We may also see an uptick in portfolio sales, but that will depend on how the pandemic unfolds. Perceived support from the ECB for cross-border banking mergers may also driver more deal activity.

With the (limited) number of deals currently in the market, we continue to see strong interest from PE.

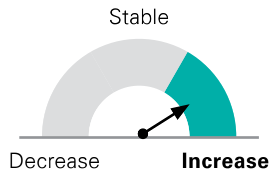
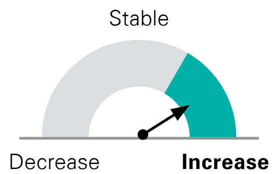


Switzerland | 2020 was a quiet year following 2019's, historically low activity. In the second half of the year, private banking consolidation picked up significantly with five mergers/take-overs of small/midsized private banks. We expect mergers amongst these banks to continue. Payments will see increased activity. While retail banking remains quiet, we see new digital offerings increasing market share of Neo banks, which could result in increased margin pressure in a market that is still very profitable.

PE interest is still rather limited but several PE firms could seek attractive investment opportunities in the private banking market.



Europe

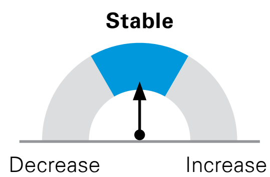
Country	PE interest	Deals 2020 vs 2021
Spain | COVID-19 accelerated the need for banks to consider potential mergers and enhance profitability through synergies. This led to the announcement in September 2020 of the CaixaBank and Bankia transaction and negotiations between Unicaja and Liberbank, among others. In 2021, we expect completion of transactions announced in 2020 leading to the reorganization of many alliances (insurance, servicing, consumer finance). The Spanish banking sector will finally kick-start a second long-awaited consolidation wave, addressing low sector profitability and prepare for cross-border activity. We will also see the creation of NPL portfolios that will feed the market in coming months. Additionally, smaller banks and cooperative banks continue reviewing their business models to adapt to the challenging environment regarding heightened regulatory pressure.	PE may be interested in specific banking niches, such as private banking, payments and SME lending. Once the NPL portfolio market recovers, specialized funds may be active again.	
UK | In 2020, COVID-19 paused the market while buyers and sellers assessed the pandemic's impact on strategy and pricing. We saw a shake out of the P2P industry. P2P platforms – reliant on retail providers for liquidity – struggled and in many instances were forced to sell. In the consumer finance (POS) sector, we saw significant interest in providing flexible consumer credit options at the retail POS. At the end of the year it also appeared that a number of mid-tier banks would also come to market amid structural and economic pressures weighing on the sector. Digital transformation is also quickly reshaping the commercial finance space, especially for supply chain finance and the flow of commercial data. Commercial finance services offered by banks are now fueled by technological capabilities that prioritize customer/client expectations and address the needs of small and large corporate clients. We expect a continuation of both consumer and commercial finance trends in 2021. As we head into 2021, the focus will shift to NPLs as government stimulus measures wear off and the economic impact of COVID-19, and any additional Brexit effects, impact on consumer and corporate borrowers. It is unclear how NPLs with attached government guarantees will recover and to what extent a secondary market will emerge. Finally, the need for a seamless digital customer journey has risen and new entrants continue to slice off profitable parts of business and customer relationships. Banks that can manage this digital revolution to the benefit of their extensive customer bases and who can generate broader fee revenues will thrive.	NPLs and Market infrastructure — with profits moving away from investment banks to industry platforms -the value of those platforms, and related connectivity and data providers, continues to rise.	

Americas

Country	PE interest	Deals 2020 vs 2021

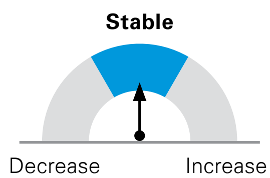
Argentina | The M&A market has not shown bank transactions for 2020 period, maintaining 2019's inactivity. Some interest in wealth management has occurred for brokerage firms while several banks are starting to position themselves in the payments industry by establishing a venture capital arm. Banks have significant exposure to the public sector, and therefore their books are linked to the performance of Argentinean public debt. The sector has been hit hard by the Argentinean crisis, with market prices down 80 percent from 2017 highs and no clear recovery path for 2021.

PE that operates within the country is not active in the banking sector. The sector is not expected to become an attractive segment in 2021.

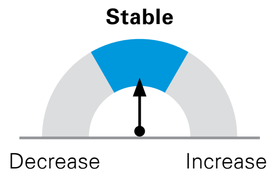
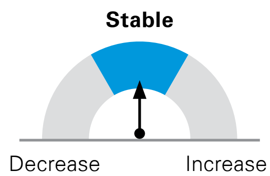
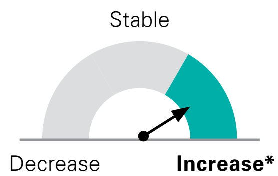


Brazil | Financial services proved resilient during COVID-19 with Fintech and digital banking driving M&A both in 2019 and 2020. Open banking, payments solutions, and cash management solutions have been the main drivers. We expect deal activity in 2021 to increase with the recovery of the capital markets and investor capital flow to Fintech. Asset management will also be an opportunity for investment with some international players re-entering the market.

PE to remain active in Fintech, digital solutions and payments solutions.



Americas

Country	PE interest	Deals 2020 vs 2021
Canada | In 2020, regulated banking institutions hit pause. Non-regulated lending (point of sale, small/medium businesses) saw a degree of activity while payments organizations were active in international acquisitions. In 2021, Canadian banks will continue to display cautious optimism, entertaining potential acquisitions with great care. We may see possible disposal of non-core activities by banks and continued merger of credit unions following challenging economic conditions, technology investments and regulatory compliance requirements. Banks will continue investing in technology, with a mix of in-house, partnership or M&A. Fintech lending operators should see more activity as the current economic conditions brought on by COVID-19 will stress individuals and SMEs that have relied on these players.	Continued interest in non-regulated lending and payments. Acquisition of non-core activities of banking groups.	
Mexico | Deal activity remained unchanged in 2019 and 2020. In 2021, transactions are expected to remain stable with activity expected in Fintech, the sale of NPLs and possible industry consolidation as weak players go out of business. The market expected a major merger between two Spanish lenders but, discussions collapsed after the banks disagreed over transaction pricing.	PE expected to remain active only in the purchase of NPL portfolios.	
US | We expect 2021 to start where 2020 left off, with consolidation of regional players to creating super regional and national franchises. Subject to regulatory changes from the new administration, we expect a high volume of bank consolidation throughout the year with banks taking advantage of resulting cost savings to invest in becoming more digitally agile in order to serve the demands of a post COVID-19 customer base. Banks are looking more at their product portfolio and disposing of non-strategic and underperforming segments.	PE will remain active in Fintech and challenger banks but bank holding company regulations will continue to keep them largely outside of bank investing. PE seems ready to get back into specialty finance on a limited basis, but we believe that banks will be the primary buyers in that space.	 (assuming no regulatory changes from the new administration)

Authors and contributors

Authors

Giuseppe Rossano Latorre
Global Financial Services
Deal Advisory Lead
KPMG in Italy
T: +39 0267643918
E: glatorre@kpmg.it

Giovanni Santella
Director, Global Financial
Services Deal Advisory
KPMG in Italy
T: +39 02676431
E: gsantella@kpmg.it

Cheena Sharma
Assistant Manager, Global Financial
Services, Deal Advisory Support
KPMG Global Services
T: +91 124 669 1459
E: cheenasharma@kpmg.com

Key contributors

ASPAC

Canopus Safdar
Director
KPMG in Thailand
T: +6626772603
E: csafdar@kpmg.co.th

Craig Mennie
Partner
KPMG Australia
T: +61 2 9335 8671
E: cmennie@kpmg.com.au

David East
Partner
KPMG in Indonesia
T: +62215740877
E: david.east@kpmg.co.id

Kenichiro Kato
Partner
KPMG in Japan
T: +81335485462
E: kenichiro.kato@jp.kpmg.com

Louis H.C. Ng
Partner
KPMG China
T: +86 108 508 7096
E: louis.ng@kpmg.com

Stephen Bates
Partner, Financial Services Deal Advisory
Lead (Asia)
KPMG in Singapore
T: +65 62 132 442
E: stephenbates1@kpmg.com.sg

Europe

Borja Peñas De Bustillo
Partner
KPMG in Spain
T: +34914565934
E: bpenas@kpmg.es

Christian Hintermann
Partner
KPMG in Switzerland
T: +41 58 249 29 83
E: chintermann@kpmg.com

Jan Oudejans
Partner
KPMG in Netherlands
T: +31206 567347
E: oudejans.jan@kpmg.nl

Jeremy D Welch
Partner
KPMG in the UK
T: +44 20 73112527
E: jeremy.welch@kpmg.co.uk

Silvano Lenoci
Partner, Co-Head of Global M&A
Banking & Insurance
KPMG in Italy
T: +3902676431
E: slenoci@kpmg.it

Tamas Simonyi
Partner
KPMG in Hungary
T: +36 1 887 7128
E: tamas.simonyi@kpmg.hu

Thomas Gross
Partner
KPMG in Germany
T: +49 69 9587-3763
E: tgross@kpmg.com

Yves Courtois
Partner
KPMG in Luxembourg
T: +3522251517503
E: yves.courtois@kpmg.lu

Americas

Andrea Oteiza
Head Deal Advisory & Strategy
KPMG in Argentina
T: +541148915669
E: aoteiza@kpmg.com.ar

Federico Hernandez
Partner
KPMG in Mexico
T: +525552468620
E: federicohernandez@kpmg.com.mx

Fernando A C S B Mattar
Partner
KPMG in Brazil
T: +551139408382
E: fmattar@kpmg.com.br

Georges Pigeon
Partner
KPMG in Canada
T: +1 514 840 2178
E: georgespigeon@kpmg.ca

Timothy Johnson
Partner, Financial Services Deal
Advisory Lead (Americas)
KPMG in the US
T: +1 312 665 1048
E: tejohnson@kpmg.com

Methodology

Deals data

The information presented in the report is an analysis of announced deals in the banking sector in 2020, accessed in January 2021. The data has been sourced from Thomson One, where the target company belongs to any of the following sectors: all forms of banking — commercial, private, investment, retail, corporate; payment services; credit institutions; brokerage firms/houses; diversified financials/conglomerates; business support services. There are certain adjustments made to the data to select only relevant data from the mentioned sub-sectors and exclude transactions of debt restructuring, buyback, repurchases and exchange offers. Certain sub-sectors such as accounting, auditing, bookkeeping services, and miscellaneous intermediation have been excluded. The analysis is conducted on M&A transactions including deal status of completed, pending and pending regulatory. Additionally, data is continuously updated and is therefore subject to change. It may not exactly replicate the last year numbers as there are continuous additions that have been made in the back end from database.

Sector performance

Bloomberg database has been extensively used to build valuation and regression analysis for top regional banks. Top banks have been considered based on market capitalization. All data has been extracted as on 27th November 2020.

Survey

An internal KPMG survey was conducted with Deal Advisory (DA) banking leads of approximately 20 countries. The survey covered three aspects — expected trends in banking deal environment in 2021, PE impact on deal activity and whether deal volume is expected to remain stable, increase or decrease over 2020. For each country, the information has been provided by the respective KPMG DA banking leads. Country level analysis is based on the survey inputs.

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