

Sharing deal insight European Financial Services M&A news and views

This quarterly report aims to provide perspectives on the recent trends and future developments in the European Financial Services M&A market, including analysis of the latest transactions and insights into emerging investment opportunities.

November 2010



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€16.8 billion

*of financial services deals in the third quarter,
up more than 50% on the previous three
months*

€2.3 billion

*takeover of RBS Global Merchant Services
highlights renewed interest from
private equity*

Welcome

to the new format of our quarterly report into M&A in the European financial services sector.

Formerly known as European Financial Services M&A Insight, Sharing deal insight provides perspectives on the recent trends and future developments in the M&A market, including analysis of the latest transactions and insights into emerging investment opportunities.



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Acquisition values rose sharply in the third quarter of 2010 as the impetus for M&A continues to accelerate. While restructuring is still a strong theme, the upsurge in cross-border deals confirms that growth is firmly back on the agenda. More than half of the value and six of the ten biggest deals in the quarter involved foreign buyers (see 'Data Analysis').

For international groups looking to develop and strengthen their presence in fast-growth emerging markets, it would be difficult to ignore the Middle East, one of the world's richest and most economically critical regions. The region's banking sector has weathered the financial storm and is set for renewed growth. Islamic finance is showing particularly strong resurgence and future potential. However, with a fresh round of consolidation on the cards and valuations set to rise, it will be important to act soon or face higher entry costs in the future (see 'Developing a successful Middle Eastern strategy').

Another key focus for growth is Turkey, a rapidly expanding but still under-penetrated banking market. The Turkish banking sector underlined its investment potential by sustaining profitability and growth throughout the global financial

crisis. Turkey's relatively young and expanding population will help to drive economic growth and increasing demand for credit in the years to come (see 'Buying into Turkey's sustained growth').

The M&A market looks set to maintain its momentum over the coming quarter. Private equity will continue to play an influential role in driving deal activity. In turn, restructuring and resulting divestment will continue to open up targets for acquisitive expansion. The impetus for restructuring is likely to be especially strong within insurance, as Solvency II spurs companies to review their product set, capital efficiency and underlying strategic priorities (see 'Looking Ahead').

We hope that you find this edition of Sharing deal insight interesting. Please do not hesitate to contact either of us or any of the article authors if you have any comments or questions.

Data Analysis

European financial services M&A transactions experienced a notable acceleration during the third quarter of the year, driven by a number of significant banking transactions. Although restructuring remains a key driver of deal activity, bidders are becoming more growth-oriented.



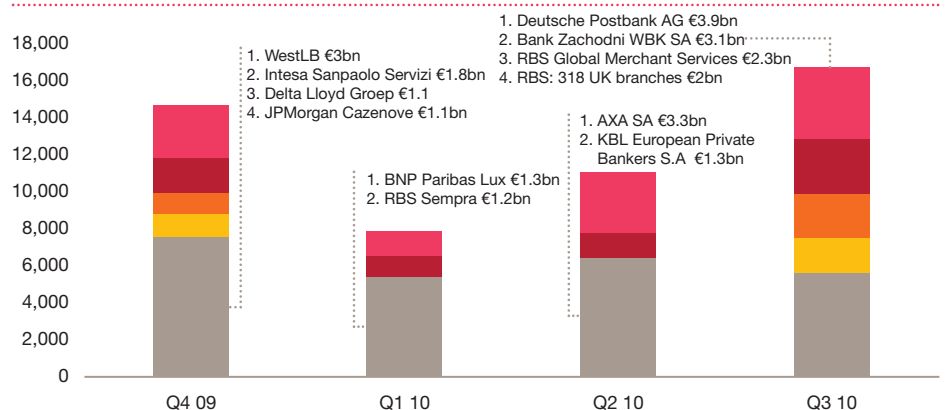
The overall value of European financial services M&A included in our dataset grew to €16.8bn during the third quarter of 2010.¹ This represents an increase of 54% from the previous quarter's figure of €10.9bn and an improvement of 87% on the €9bn recorded during the comparable quarter of 2009 (see Figure 1).

The growth in deal values was driven by an increase in activity involving banking targets, which moved up to €13.2bn from €6bn in the second quarter of the year (see Figure 2). In contrast, deal activity

among asset managers remained stable and insurance transactions were unusually modest, with the two sectors recording deals worth €1.1bn and €1.3bn respectively.

The data was dominated by the four largest deals announced during the quarter (see Figure 1). All four were valued between €2bn and €4bn, all four involved banking targets and in two cases Santander was the buyer.

Figure 1: Quarterly European FS deals by value (€m)

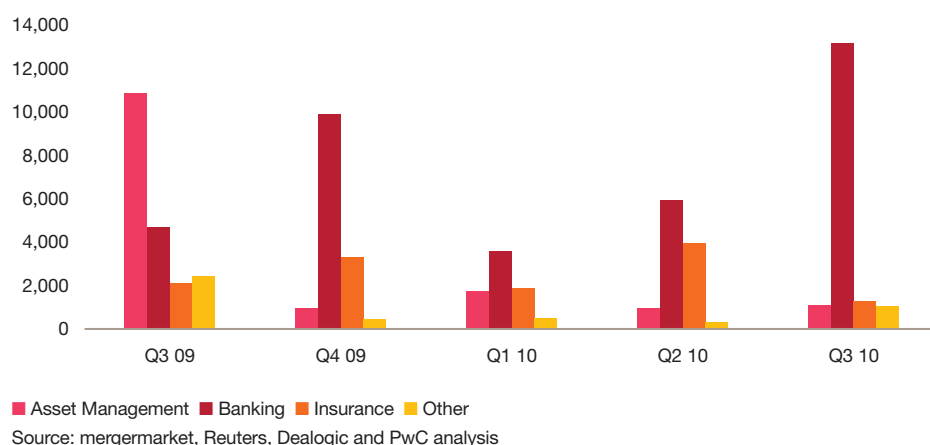


¹ The source data for the deals analysed in this publication come from mergermarket, Reuters and Dealogic, unless otherwise specified. Our analysis methodology is summarised on P17.

Source: mergermarket, Reuters, Dealogic and PwC analysis

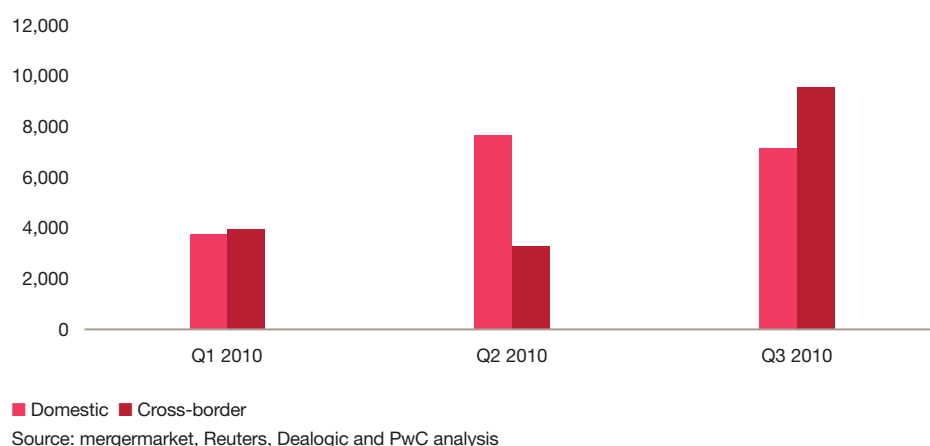
The quarter's four largest deals highlight the continuing role of banking restructuring in European financial services M&A. Both of the sales by Royal Bank of Scotland were requirements of EU state aid conditions, and AIB's decision to sell its stake in Zachodni was driven by a need to raise capital.

Figure 2: Quarterly European FS deals by value – subsector analysis (€m)



The quarter's four largest deals highlight the continuing role of banking restructuring in European financial services M&A. Both of the sales by Royal Bank of Scotland were requirements of EU state aid conditions, and AIB's decision to sell its stake in Zachodni was driven by a need to raise capital. Both banks made other, smaller disposals during the quarter, and they were not alone. KBC and companies of the former Fortis group both made a number of divestments during the period. The announcement since the end of the quarter that Banco Bilbao Vizcaya Argentaria (BBVA) has acquired a 24.9% stake in Garanti Bank of Turkey³ underlines the ongoing importance of restructuring as a driver of deal activity.

Figure 3: Quarterly European FS deals by value – domestic v. cross-border (€m)



Even so, the fact that three of the quarter's four largest deals involved cross-border bidders also suggests that – as predicted in the last edition of *Insight* – buyers are becoming more focused on growth. Nor was cross-border activity limited to the top end of the market. Our dataset includes more than €2bn of cross-border mid-market and smaller deals announced during the quarter. The net effect is that the overall value of cross-border transactions exceeded domestic deals by an appreciable margin, making up 57% of all deal value during the quarter compared to an average of 41% for the first two quarters of the year (see Figure 3).

- Deutsche Bank announced its intention to acquire the 70% of Deutsche Postbank it does not already own for a provisional consideration of €3.9bn, to be funded by its recent rights issue;²
- Santander agreed to acquire Allied Irish Bank's 70% holding in Bank Zachodni WBK of Poland (and its 50% stake in BZ WBK Asset Management) for a total consideration of €3.1bn;
- Royal Bank of Scotland sold its Global Merchant Services business to two US private equity firms – Advent International and Bain Capital – for €2.3bn; and
- Santander agreed to purchase 318 of Royal Bank of Scotland's UK branches, along with their associated assets and liabilities, for €2bn.

² 'Deutsche Bank completes rights issue', *Financial Times*, 06.10.10.

³ BBVA media release, 02.11.10.

The involvement of two private equity buyers in Royal Bank of Scotland's €2.3bn sale of its Global Merchant Services unit was also significant.

Figure 4: Top 10 Deals Q3 2010

Month	Target company	Target country	Acquirer company	Acquirer country	Deal Value (€m)
Sep	Deutsche Postbank (70%)	Germany	Deutsche Bank AG	Germany	3,882
Sep	Bank Zachodni WBK (70%)	Poland	Banco Santander SA	Spain	3,088
Aug	RBS Global Merchant Services	UK	Advent International Corp; Bain Capital Inc	USA	2,290
Aug	Royal Bank of Scotland - 318 UK branches	UK	Banco Santander SA	Spain	1,992
Sep	FIH Erhvervsbank A/S	Denmark	ATP; PFA Pension; Folksamgruppen; CP Dyvig & Co A/S	Denmark	671
Jul	SEB AG - German retail banking operations	Germany	Banco Santander SA	Spain	555
Jul	Bank of Scotland Integrated Finance	UK	Cavendish Square Partners LP - 70% owned by Collier Capital	UK	400
Aug	DataCash Group plc	UK	MasterCard Inc	USA	383
Sep	Equity Trust Holdings SARL	Netherlands	Doughty Hanson & Co	Netherlands	350
Jul	Secura NV	Belgium	QBE Insurance Group Ltd	Australia	267
			Sub-total		13,878
			Other		2,947
			Grand total		16,825

Source: mergemarket, Reuters, Dealogic and PwC analysis

The involvement of two private equity buyers in Royal Bank of Scotland's €2.3bn sale of its Global Merchant Services unit was also significant. This was by far the largest private equity direct transaction in European financial services recorded since before the financial crisis, and there were also a number of private equity-backed transactions in the mid-market. In total, private equity-related deals announced during the quarter were valued at €3.3bn, or 20% of the total. This appears to validate the impression that private equity firms drawing down on their committed funds are playing an increasingly influential role in European financial services M&A.

Turning to the rest of the quarter's largest deals (see Figure 4), several transactions reinforce the impression of more cross-border and growth-focused deal making, as well as growing private equity activity:

- Santander's branch network acquisitions in the UK and Germany (for €1,992m and €555m respectively)

were consistent with the diversified growth rationale behind the Bank Zachodni deal. The UK deal gives the bank instant scale in the lucrative SME market, where Santander hopes to emulate the earnings growth it has achieved in UK retail banking. Santander has also identified Germany as a core market and will use the SEB deal to build on its existing consumer finance business.

- The acquisition of RBS Global Merchant Services was not the only significant private equity deal of the quarter. Lloyds Banking Group sold a 70% stake in Bank of Scotland Integrated Finance, the former HBOS venture capital business, to secondary specialist Collier Capital for €400m. Doughty Hanson's €350m acquisition of the trust and administration service provider Equity Trust was a reminder of the attractions of highly visible cash flows and low capital requirements. Doughty Hanson plans to merge Equity Trust with TMF Group, another portfolio business.

- Although very different transactions, MasterCard's purchase of UK electronic payments specialist DataCash (for €350m) and QBE Insurance's acquisition of Secura NV from KBC (for €267m) both exemplified the search for diversified growth. The first deal is intended to provide long-term growth by leveraging DataCash's products and services across MasterCard's global network. The second gives QBE, which has an M&A-driven growth strategy and has made more than 40 acquisitions since 2005, greater scale in the European reinsurance market.

In addition to the quarter's largest transactions our dataset records over 250 other financial services deals, although most have no verifiable value. Three features of this activity – each of which was predicted in the last edition of *Insight* – caught our eye:

- **Rapid consolidation among Spanish savings banks.** Spanish savings banks have been merging fast, with the number of Cajas falling from more than 40 to fewer than 20 in the space of a few months.⁴ In addition to a number of bilateral mergers, two transactions took place which saw several Cajas joining together in contractual groups known as SIPs. These were not conventional mergers, and no deal values were disclosed. However, data released by CECA, the Caja association, on the capital positions of the Cajas involved as at 30 June 2010 suggests that both of the new groups have several billion Euros of capital.
- **Deal activity involving targets in South Eastern Europe,** especially Turkey (see 'Buying into Turkey's sustained growth'). Among the most notable were Vienna Insurance Group's €126m acquisition of TBIH, a Dutch business with insurance operations in Turkey, the Ukraine and Georgia; Milli Reasurans' purchase of a 36% stake in Anadolu Sigorta, a local insurance rival (also for €126m); and the sale of Fortis' former Turkish



57%
of deals were
cross-border
acquisitions

banking operations to Türk Ekonomi Bankasi (TEB), the local bank 50% owned by BNP Paribas, for an undisclosed amount. The announcement of BBVA's acquisition of a stake in Garanti Bank⁵ is a further reminder of the attractions of the Turkish banking sector to foreign bidders.

- **Consolidation among UK insurance brokers and investment advisers.** These transactions were either very small or without disclosed deal values, but the fact that seventeen such deals were announced during the quarter suggests that small brokers and advisers could be moving to boost their scale in anticipation of the FSA's Retail Distribution Review, due to come into force at the end of 2012.

In each case it will be interesting to see whether these develop into sustained trends, or whether they prove to be short-term features of the financial services deal market.

⁴ 'Banks and cajas not yet out of the woods', *Financial Times*, 05.10.10.

⁵ BBVA media release, 02.11.10.

The banking sector in the Middle East has doubled in size since 2005 (total assets stood at more than a trillion dollars at the end of 2009).

Developing a successful Middle Eastern strategy

With the Middle East moving back to higher growth levels and the penetration of banking services still low in comparison to the size of the region's economy, interest from international investors is increasing. How can potential investors make the most of the Middle East's vast potential?



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For international groups looking to develop and strengthen their presence in fast-growth emerging markets, it would be difficult to ignore one of the world's richest and most economically critical regions.

The banking sector in the Middle East has doubled in size since 2005 (total assets stood at more than a trillion dollars at the end of 2009).⁶ Loan markets expanded rapidly in the years leading up to the

financial crisis (more than 40% in the UAE and 30% in Saudi Arabia in 2008).⁷ Confidence was subsequently affected by some high-profile local defaults and the difficulties faced by Dubai World, a government of Dubai investment fund. However, the banking sectors in most Gulf Co-operation Council (GCC) states were able to sustain profitability, growth and strong capital adequacy ratios in 2008 and 2009 (see Figure 1).

Figure 1: Recent trends in GCC banking by country (US\$m)

Country	CAR ¹	Assets ²		Growth ²	Profit ²		Return on assets ²	
	2010	2009	2008		2009	2008	2009	2008
Bahrain	19.6%	99,831	109,014	-8.4%	178	-430	0.2%	-0.4%
KSA	20.6%	348,705	336,841	3.5%	6,862	7,106	2.0%	2.1%
Kuwait	17.2%	149,203	150,025	-0.5%	1,305	1,183	0.9%	0.8%
Oman	15.5%	23,730	23,786	-0.2%	312	423	1.3%	1.8%
Qatar	16.1%	104,806	91,275	14.8%	2,567	2,574	2.4%	2.8%
UAE	20.3%	323,651	296,921	9.0%	3,990	5,202	1.2%	1.8%

1 Regulatory capital to risk-weighted assets (figures for all banks in the country)

2 Based on figures for 50 largest banks by assets in the GCC

Source: Source: Published financial statements and IMF

6 *Entering the Gulf financial services market*, published by PwC in 2007 and published financial statements.

7 *Impact of the financial crisis on the GCC*, updated by the IMF in June 2010.

Figure 2: Top ten banks in the Middle East as of 31.12.09 (US\$m)

			Assets		Growth	Profit		Return on equity	
			2009	2008		2009	2008	2009	2008
1	Emirates NBD	UAE	76,724	76,992	-0.3%	911	1,004	10.5%	14.3%
2	National Commercial Bank	KSA	68,811	59,147	16.3%	1,080	562	13.8%	7.7%
3	National Bank of Abu Dhabi	UAE	53,636	44,888	19.5%	823	823	14.8%	21.0%
4	SAMBA	KSA	49,595	47,704	4.0%	1,217	1,188	20.2%	22.2%
5	Qatar National Bank	Qatar	49,199	41,739	17.9%	1,149	1,003	21.0%	21.9%
6	Riyad Bank	KSA	47,157	42,574	10.8%	810	704	10.7%	10.3%
7	Al Rajhi Banking and Investment Corporation	KSA	45,641	43,981	3.8%	1,809	1,740	23.5%	24.1%
8	National Bank of Kuwait	Kuwait	44,716	43,389	3.1%	924	933	14.5%	16.4%
9	Abu Dhabi Commercial Bank	UAE	43,618	40,220	8.4%	(140)	370	-2.7%	8.5%
10	Kuwait Finance House	Kuwait	39,354	37,391	5.3%	250	619	4.6%	11.0%

Source: Published financial statements

The region's top ten banks have also continued to deliver strong returns (see Figure 2), with many using the downturn as an opportunity to review and modify lending policies.

Standard Chartered has provided a strong vote of confidence by announcing that it intends to 'step up its focus on the Middle East'.⁸ The bank is reported to be aiming to double its revenues from the region to \$4 billion over the next three to five years through a combination of organic growth and acquisition.⁹ Islamic finance is set to form a key part of Standard Chartered's growth plans. HSBC, the region's largest international bank, has also been seeking to strengthen its presence, with an increasing focus on the mass affluent market.

Future prospects

The prospects for international groups have been bolstered by the swift rebound in the economy of the Middle East, which is set to grow by more than 4% a year over the next three years.¹⁰ Oil prices are pushing past \$80 per barrel once again, which is above the oil price projections used to set many government budgets in the region.¹¹ Steps to diversify output beyond oil and gas also appear to be paying off. It is notable that non-oil GDP grew by 5% in 2009.¹²

In a more risk averse and financially constrained environment it may be some time before we see a return to the loan market expansion seen prior to the crisis. However, credit growth rates have begun to rise once again in a number of countries including Saudi Arabia.¹³ In the long term, the generally low loan

penetration rates across the region offer significant opportunities for further growth. In particular, the loan to GDP ratios in Saudi Arabia and UAE, the region's two largest economies,¹⁴ are running at around 40%¹⁵ and 75%¹⁶ respectively, compared to more than 100% in many mature markets.

While project finance and other support for real estate and infrastructure development will continue to be a crucial source of revenue, there are signs that both local and international institutions are keen to diversify and build up their consumer, SME and wealth management businesses. As they look to put their loan portfolios onto a more controlled and sustainable basis in the wake of recent credit losses, many banks are moving away from 'name' lending towards credit decisions based on more established credit risk analysis.

The region's favourable demography is set to provide a strong spur for long-term growth in credit cards, vehicle loans and other forms of consumer finance – it is estimated that around 65% of the population is under 30.¹⁷ The mortgage market is also opening up in a number of states. The planned new Saudi Mortgage Law could provide the catalyst for expansion in the country and a possible model for other GCC states, though there is as yet no firm timetable for enactment.

8 Standard Chartered media release, 02.07.10.

9 Dow Jones Newswires, 06.06.10 and 'Keeping faith', *The Banker*, 01.08.10.

10 World Bank *Global Economic Prospects: MENA region review*, Summer 2010.

11 'GCC's 2010 fiscal position strong on oil prices', *Emirates* 24-7, 11.05.10.

12 *The financial crisis, recovery and long-term growth in the Middle East and North Africa*, published by the World Bank in May 2010.

13 *Impact of the financial crisis on the GCC*, updated by the IMF in June 2010.

14 Economist Intelligence Unit, August 2010.

15 Saudi Arabian Monetary Agency August 2010.

16 Central Bank of UAE, September 2010.

17 Presentation by the Middle East Youth Initiative, 22.05.10.

One of the most important targets for growth is Islamic finance. The GCC is the world's largest market for Sharia-compliant products, accounting for more than 40% of the total assets of Islamic financial institutions.¹⁸ Islamic banking makes up 17% of banking assets in the GCC and is expected to grow at between 15-20% a year.¹⁹ Key developments include the renewed interest in Islamic bond (Sukuk) issues, which having dipped below \$100 million in the first quarter of 2009, have exceeded \$3 billion in three of the past five quarters (see Figure 3). HSBC is the leading underwriter of Islamic bonds in the GCC, with volumes topping \$1 billion in the first half of 2010. Deutsche Bank is also strongly positioned in third place.²⁰

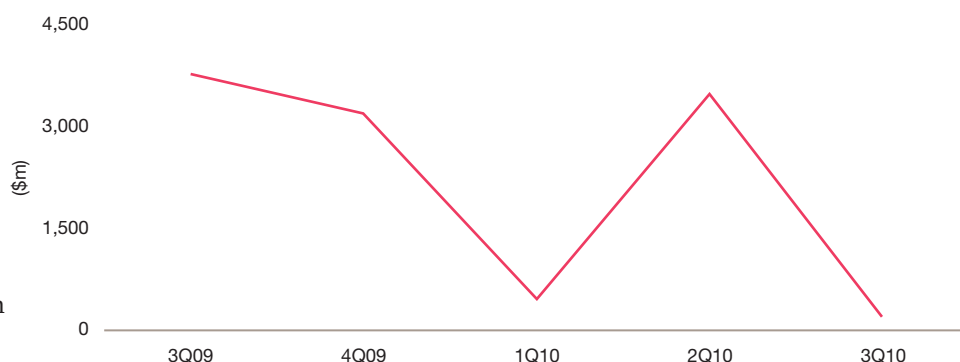
Realising the potential

For banks looking to follow a universal model, no Middle East strategy is likely to be viable in the long term without a presence in Saudi Arabia. The kingdom is not only the region's leading economy, but also has the largest population in the GCC (27 million).²¹ The fact that four of the region's largest banks are based in Saudi Arabia attests to its status.

As a member of the G20, Saudi Arabia has given strong backing to the proposals for enhanced transparency and macro-prudential supervision set out by the Financial Stability Board on behalf of the G20. These reforms will help to strengthen stability, integrate Saudi Arabia more closely into the global financial system and facilitate further development of the market.

A number of international groups already have well-established operations in Saudi

Figure 3: Sukuk issues in the Middle East and North Africa



Source: Zawya

Arabia, including HSBC through its associate SABB (formerly the Saudi British Bank), in which HSBC has a 40% stake.²² RBS also has a strong presence through its 40% holding in Saudi Hollandi,²³ though RBS may be considering a sale of its stake according to press reports.²⁴ A number of groups have also acquired banking licences in recent years including Deutsche Bank, JP Morgan and BNP Paribas.²⁵ However, it would appear that the authorities are now keen to curtail the issue of licences, for the time being at least, and therefore acquisition is the only real option for entry in the short term. The number of available targets is limited and control premiums are therefore likely to be high.

Bahrain is the region's traditional financial services hub and has long welcomed investment from the state's neighbours and foreign banks. In turn, the Dubai International Financial Centre continues to provide an important focus for wholesale banking and insurance,

though not retail banking. Qatar has a large banking sector in comparison to its population (less than one million), reflecting its importance as a focus for sovereign wealth funds. The banking sector in Kuwait is less open than other GCC states. Foreign banks are restricted to one branch and cannot compete in the retail market.²⁶

While most international attention has tended to focus on the oil rich Gulf, some groups are now looking further afield. Lebanon has one of the region's fastest expanding banking sectors and an economy that is expected to grow by 6% this year.²⁷ It is notable that this year's largest financial services deal in the Middle East was the acquisition of Credit Libanais, a leading Lebanese bank²⁸ (Figure 4 outlines the five most valuable deals). Other potential opportunities include Libya, which is increasingly keen to attract foreign investment into its banking sector.

Even where licences are available, gaining a significant presence in the face of entrenched competition from local and existing international players may be difficult. Some institutions may therefore look to acquisition as a faster way to establish a significant presence. The M&A market is set to become more active as governments seek to encourage consolidation within what are often

As a member of the G20, Saudi Arabia has given strong backing to the proposals for enhanced transparency and macro-prudential supervision

Editorial eye

The Middle East banking sector offers significant potential for investment and growth. However, with a fresh round of consolidation on the cards and valuations set to rise, it will be important to act soon or face higher entry costs in the future.

40%

of the total assets of Islamic financial institutions are located in the GCC and Islamic banking is expected to expand by 15-20% a year

Figure 4: Top five financial services deals in the Middle East in 2010

Month	Target company	Target country	Acquirer company	Acquirer country	Value (€m)
Aug	Credit Libanais (65%)	Lebanon	EFG Hermes	Egypt	425
Jul	Burgan Bank (20%)	Kuwait	United Gulf Bank	Bahrain	266
Sep	Gulf Insurance Co (39%)	Kuwait	Fairfax Financial	Canada	160
Jul	Arabeya Online (90%)	Egypt	Bank Audi	Lebanon	36
Apr	Kuwait Clearing Co	Kuwait	International Financial Advisors	Kuwait	28

Source: Dealogic and Reuters

fragmented local banking sectors. In turn, the financial services sector in the region as a whole is becoming more competitive and sophisticated, with the resulting rise in quality likely to affect valuations. Timing is therefore critical for international groups eyeing up opportunities in the GCC and wider Middle East. Delays could make market entry more expensive and challenging.

There may also be openings for joint ventures in niche areas such as mortgages, credit cards, wealth management and bancassurance. Examples include Standard Chartered Saadiq's partnership with Salama Islamic Arab Insurance, which has enabled Standard Chartered to expand its range of Sharia-compliant savings and wealth management plans.²⁹

Seizing the prize

The economic fundamentals of the Middle East continue to be sound, with oil and gas being supplemented by increasing commercial diversification. The banking sector has weathered the financial storm and is set for renewed growth. Islamic finance is showing particularly strong resurgence and future potential. Whether looking to build, buy or establish a joint venture, local knowledge and the ability to form strong relationships are critical to entry and development. Governments, regulators and customers will also favour investors that can demonstrate a long-term commitment to the region.

18 HSBC Amanah media release, 05.11.09.

19 Middle East Company News, 26.09.10.

20 *Islamic Capital Markets League Tables First Half Year 2010*, published by Bloomberg.

21 Economist Intelligence Unit, August 2010.

22 SABB website, 15.10.10.

23 Saudi Hollandi website, 15.10.10.

24 'RBS eyes Saudi Hollandi stake sale', 18.05.10.

25 Economist Intelligence Unit, 04.06.10.

26 *2010 Investment Climate Statement – Kuwait*, published by the US Department of State, March 2010.

27 *IMF World Economic Outlook*, April 2010.

28 EFG Hermes media release, 17.08.10.

29 Standard Chartered media release, 05.05.09.

Buying into Turkey's sustained growth



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The Turkish banking sector underlined its investment potential by sustaining profitability and growth throughout the global financial crisis. How can international banks buy into this expanding but still under-penetrated market?

'Turkey is a market that offers great potential. Turkey has a rapidly growing economy with attractive demographics,' said Wilfred Nagel, CEO of ING Bank Turkey, in a trading statement earlier in the year. 'The banking industry in Turkey is still relatively small compared to the country's GDP and therefore offers the prospect of stronger growth compared to many European countries.'³⁰

ING is Turkey's tenth largest bank, having acquired Oyak Bank in 2007³⁰ (see Figure 1). Other foreign banks with 100% or majority holdings in the Turkish top ten include Dexia (Denizbank) and National Bank of Greece (Finansbank). Citibank (Akbank), BBVA (Garanti) and Unicredit (Yapi ve Kredi as part of a joint venture with the Koç Group) also have significant minority stakes (see Figure 1).

Figure 1: Turkey's top ten banks (as of 30.06.10)

Bank	Total assets (€m)	Total liabilities (€m)	Total deposits (€m)	Total equity (€m)	Net profit/loss** (€m)	Ownership	Foreign stake
Türkiye Cumhuriyeti Ziraat Bankası A.Ş.	69,141	63,332	55,530	5,809	947	State	0%
Türkiye İş Bankası A.Ş.	73,044	64,639	41,706	8,404	870	Private	0%
Türkiye Garanti Bankası A.Ş.	61,820	53,991	37,851	7,830	1,019	Private	24.9%
Akbank T.A.Ş.	58,799	50,696	36,700	8,103	896	Private	20%
Türkiye Vakıflar Bankası T.A.O.	38,189	34,107	25,883	4,081	251	State	0%
Yapı ve Kredi Bankası A.Ş.*	42,852	37,876	25,476	4,976	581	Private	0%
Türkiye Halk Bankası A.Ş.	35,479	32,133	26,610	3,346	511	State	0%
Finans Bank A.Ş.	17,226	15,051	10,550	2,175	168	Private	100%
Denizbank A.Ş.	15,043	13,341	8,817	1,702	162	Private	100%
ING Bank A.Ş.	8,573	7,515	4,911	1,057	50	Private	100%
Others	52,654	38,063	19,720	14,591	578		
Total	472,819	410,744	293,754	62,075	6,032		

* 80% shares of Yapı ve Kredi belong to 50% foreign-owned Koç Finansal Hizmetler A.Ş. ** Figures for the first six months of the year.

Source: Banks Association of Turkey

By 2050, our own analysis suggests that the asset size of the Turkish banking sector will be on a par with Italy or Spain.

In 2001, a combination of mounting portfolio losses and sudden currency devaluation led to a collapse in liquidity and confidence in the Turkish banking sector. The subsequent restructuring of the sector included consolidation (the number of banks has more than halved since 2001³¹), an overhaul of supervision and tighter lending, transparency and capital adequacy rules.

The restructuring and reforms laid the foundations for strong recovery and growth throughout the last decade (see Figure 2). It also enabled Turkey's banks to avoid the credit bubbles and destabilising exposure to toxic assets seen in other parts of Europe. While the level of impaired loans increased³² and the economy went into recession in 2009, the Turkish banking sector continued to expand and no institutions needed to be rescued by the government. Capital adequacy ratios also remained stable at around 20% (see Figure 3).

Future prospects

The prospects for the future are even stronger. Turkey is a member of the G20. It is also one of the E7 group of leading emerging economies, whose GDP is set to outstrip the G7 by 2050.³³ Having dipped in 2009, the Turkish economy has bounced back into growth in 2010 and is expected to expand by an average of around 4.5% a year over the next decade.³⁴ Its relatively young and expanding population (Turkey is set to be the second most populous country in Europe after Russia by 2030³⁵) will help to sustain growth in output and demand for credit.

High spreads have helped to sustain attractive returns within the banking sector (see Figure 4). Yet loan penetration is still low in comparison to other Central and Eastern European (CEE) states (see Figure 5), indicating the potential for further growth. By 2050, our own analysis suggests that the asset size of the Turkish banking sector will be on a par with Italy or Spain.³⁶

Figure 2: Total assets, equity and net profits of Turkish banks

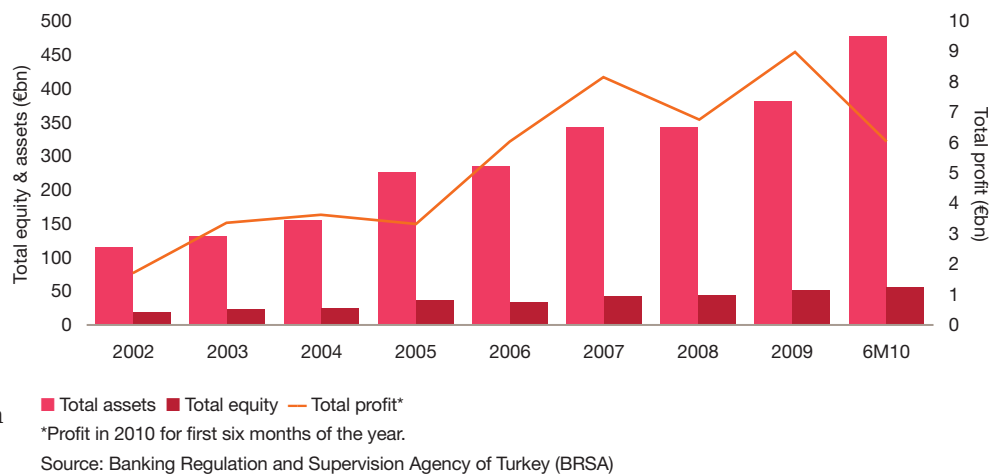
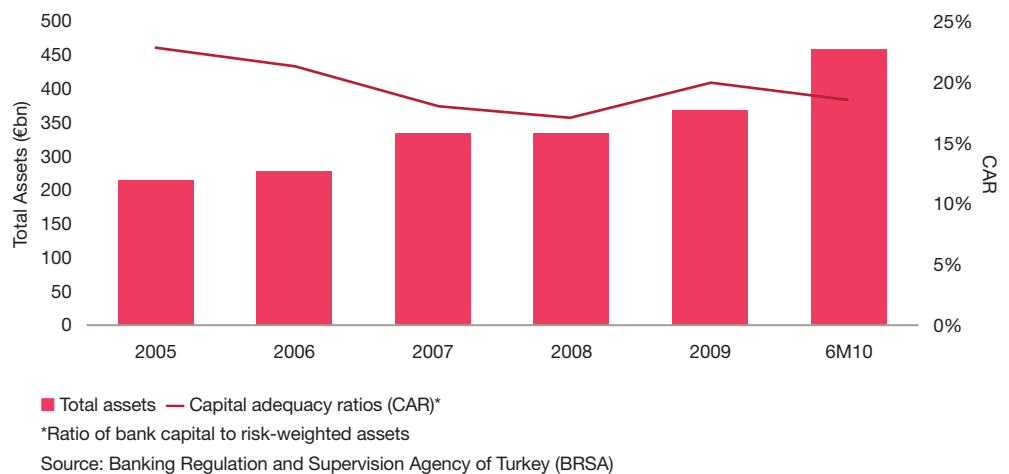


Figure 3: Capital adequacy ratios



One specific growth area is project finance in areas such as energy. Turkey is becoming a crucial hub in oil and gas transportation from Russia and the Middle East to Western Europe. The country is also undergoing a major expansion of roads, schools and hospitals. On the retail side, legislation passed in 2007 has paved the way for the introduction of long-term mortgages and the market is set for rapid expansion. Other relatively under-developed areas include asset management.

30 ING Bank Turkey media release, 30.08.10.

31 Banks Association of Turkey website, 14.10.10.

32 BRSA website, 21.10.10.

33 *The World in 2050*, published by PwC in March 2006.

34 PwC Economics, October 2010.

35 Economist Intelligence Unit *Ten-year growth outlook*, 09.09.10 and 'Turkey's economy surged in quarter', *Wall Street Journal*, 15.09.10.

36 *Banking in 2050: How big will the emerging markets get*, published by PwC in 2008.

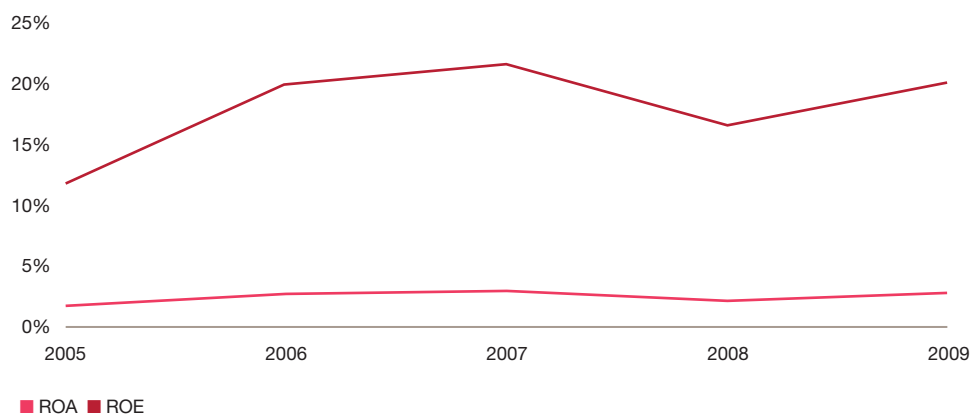
Further growth opportunities come from Islamic finance. While still small (less than 5% of total bank assets in Turkey) in comparison to the Middle East (see ‘Developing a successful Middle Eastern strategy’), Islamic banking has been growing at double the rate of conventional business.³⁷

An international investment opportunity

Turkey has no restrictions on foreign ownership in the banking sector and is keen to attract international investment. A number of international banks have set up greenfield operations. However, the minimum paid up capital requirement is \$300 million³⁸ and can take at least six months to secure. Newcomers also face the challenge of breaking into a highly concentrated market, in which the top ten banks control more than 80% of assets and loans.³⁹

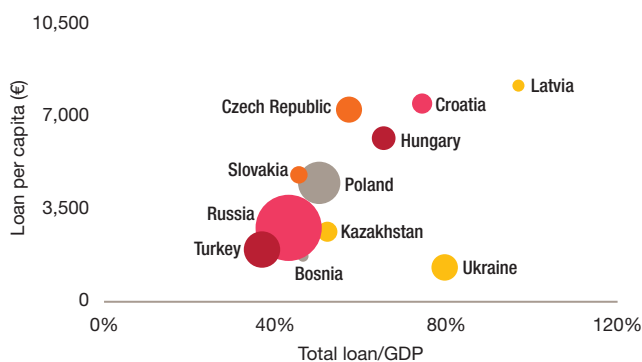
Acquisition can offer a quicker way to establish and develop a market presence. Having peaked in the lead up to the global financial crisis, price to book value (P/BV) ratios have come down to the levels seen in earlier parts of the decade (see Figure 6). However, most of the larger banks are either state owned or have significant foreign holdings already. One entry option may be seeking to buy the stake of an existing foreign investor. In November 2010, BBVA announced the acquisition of a 24.9% stake in Garanti (18.6% from GE and 6.3% from the Dogus Group).⁴⁰ Some of the smaller institutions may still be available, though developing the franchise and customer base will take time.

Figure 4: Return on assets and equity



Source: Banking Regulation and Supervision Agency of Turkey (BRSA)

Figure 5: Loan penetration in CEE



Bubbles represent relative total loan size

Source: Banking Regulation and Supervision Agency of Turkey (BRSA)

37 ‘Islamic finance: Ambitious growth targets set by country’s ‘participation banks’’, *Financial Times*, 04.05.10.

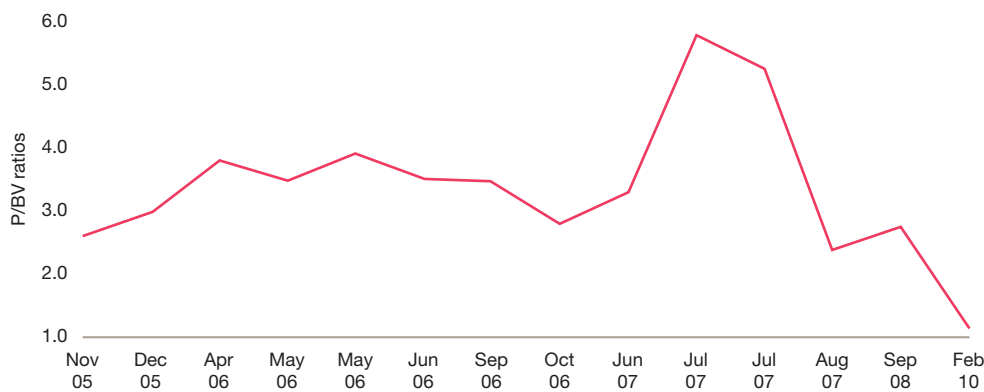
38 BRSA statement, 30.06.10.

39 Banks Association of Turkey website, 14.10.10.

40 BBVA media release, 02.11.10.

Having peaked in the lead up to the global financial crisis, price to book value (P/BV) ratios have come down to the levels seen in earlier parts of the decade.

Figure 6: Valuations of transactions in Turkish banking sector



Source: Bloomberg and mergermarket

Editorial eye

Acquiring a position in this rapidly growing G20 and E7 banking market is set to be a key target for many international groups. Yet with many of the larger private banks already in international hands, prospective entrants may need to acquire existing foreign holdings or tap into new growth areas such as mortgages, asset management and Islamic banking.



All in all, we think it is only a matter of time before we see more widespread changes in the ownership of European insurance assets.

Looking Ahead

European financial services M&A picked up strongly during the third quarter of 2010. We expect a number of drivers, some discussed in this paper, to continue to influence deal activity. Two of these drivers are increasing private equity involvement and further restructuring in the European insurance industry.



In the last edition of *Insight*, we commented on the disappointing level of European financial services M&A during the first half of 2010. Even so, we then forecast a gradual increase in transactions and predicted a return to growth-oriented deal making, albeit in a different form to the transactions of the boom years.

The third quarter of 2010 did indeed see a perceptible pick-up in growth-focused financial services M&A activity (see ‘Data Analysis’). It was particularly encouraging to observe that talk of restructuring – common currency in the financial markets during the past year – was gaining traction.

As we look towards the end of 2010 and the early part of 2011, we make some further cautious predictions about future developments in European financial services M&A. In particular, we want to focus on two areas – one where activity

has already accelerated, and one where it has recently been relatively subdued.

The first area is private equity-related activity. The build up of private equity deals has been widely discussed in the financial press, and our analysis bears out the impression that firms are committing funds to financial services investments (see ‘Data Analysis’). Combined with the overall reduction in M&A since the middle of the last decade, this expansion means that in the third quarter of 2010 the private equity industry accounted for an exceptionally large proportion of the financial services deals in our dataset.

We also note that the range of transactions attracting private equity funds is broadening, and we expect this to continue. The third quarter has seen direct bids for financial targets, support for management buyouts, secondary buyouts and the acquisition of loan portfolios.

We feel that buyout firms will continue to play an increasingly important role in European financial services M&A. This does not mean that every quarter will see large private equity deals, but we think that the influence of the sector will continue to grow, contributing to a changing European M&A landscape.

The second area is insurance-related deal activity, which has been relatively modest in recent quarters. Some large deals have taken place, but pan-European consolidation has yet to materialise and

the majority of recent transactions have been confined to the mid-market.

Still, we feel that the European insurance industry retains considerable scope for restructuring. The incoming Solvency II regime will encourage firms to maximise their capital efficiency and rethink their strategic options. Banking groups will also continue to review their ownership of insurance subsidiaries, particularly now that Basel III promises to tighten capital requirements for bancassurers.

Several European insurance groups have already taken steps to reduce their exposure to mature markets, shed sub-scale businesses and build up their operations in faster growing regions. Groups pursuing disposals include Aegon and Old Mutual, and rumours of large, scale-building transactions circulate in the markets on a regular basis.

In the UK, the consolidation vehicle Resolution has been an active acquirer, though it remains to be seen whether its model will be imitated elsewhere in Europe. The London insurance market is also a perennial source of M&A rumours, as illustrated by Apollo’s recent bids for Brit Insurance.

All in all, we think it is only a matter of time before we see more widespread changes in the ownership of European insurance assets.

Methodology

The 'Data Analysis' and 'Looking Ahead' sections in this issue include financial services deals:

- Reported by mergermarket, Thomson and Dealogic;
- Announced during the third quarter of 2010, and expected to complete;
- Involving the acquisition of a >30% stake (or significant stake giving effective control to the acquirer);
- Acquisitions of Europe-based financial services targets where a deal value has been publicly disclosed.

Since 2009, our data coverage has included Dealogic information. However, comparative figures for previous years have not been restated.

Our analysis also excludes deals that, in our view, are not 'pure' financial services deals involving corporate entities or entire operations, e.g. real estate deals and sales/purchases of asset portfolios where the disclosed deal value represents the value of assets sold.

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