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# THE DEAL DESK

GFMC Newsletter

## Bank Mergers: The New Wave

By Abhishek Sharma

A merger is a financial agreement wherein two or more companies agree to voluntarily combine to create a new legal entity. Usually the two combining entity compare equally in terms of size, customers and scale of operations. In extension, bank merger is the combination of two or more banking entities with comparable size and revenue. In this article we will try to understand the general intuitions behind a bank merger process and wrap it up with the example of the recently announced deal between Spain's Caixa Bank SA and Bankia SA, two of the larger banks in the country.

### Reasons and Motives for Banks M&A

There is a combination of two major factors in deciding any major Bank merger deals - external and firm level. We have tried to explore mainly the firm level factors which goes into the motivation for a merger deal.

### Firm level Factors and Motives

The firm level motives are those which inspires managers to go into a merger and acquisition process. The two major types are those that lead to value maximization, with the aim of increasing the value of the acquired or the new entity and mainly include synergy (economic motives), and non-value maximization where idea is separation of ownerships and control between shareholders and management.

## Highlights:

**Buyer:**

**Caixa Bank SA**

**Target Company:**

**Bankia SA**

**Valuation:**

**\$4.5 billion**

**Shareholding:**

**Caixa Foundation : 30% stake**

**Spanish Government : 16% in he combined entity**

**Bankia SA: 0.6845 shares of Caixa Bank for 1 share**

**Industry:**

**Caixa Bank SA -  
Financial Services  
Bankia SA -  
Nationalized Bank**

## Synergy

Synergy means that in the new entity the two companies are complementing each other with creating values that is more than what each can achieve individually. According to efficiency theory there are mainly three types of synergy – operational, financial and managerial. Operational synergy involves achieving economies of scale and scope by combining activities, products and markets. It is more common in horizontal mergers in which cost savings involve closing redundant branches, consolidating information systems and back offices, processing payment systems, marketing and management system and reduction of general and administration expenses. Economies of scale also allows for cross-selling where both banks can get access to niche products offered by the other bank. Managerial synergy involves where one firm possesses better managerial efficiency with the idea being that the merger would lead to better resource utilization of both the firms.

Financial synergy materializes when the cost of capital of the merged firm is lower than that of the individual firms. It may also lead to tax benefits when the profitable firm can benefit from tax laws or use losses made by the other firm in recent years to cover up for its profits. Furthermore, it also leads to risk diversification especially when mergers lead to broadening of products horizon due to unrelated, multi sectoral client base. Also risks gets further reduced when merging bank have cash flows that are not perfectly correlated. Financial regulators too require banks to have minimum capital adequacy, thus mergers result in an entity with a larger capital base than the participating firms. This enables the new institution to extend larger loans too which it may not have been able to do earlier due to capital base lending regulatory restrictions.

We will now try to explore this better by trying to understand the recently announced deal between Caixa Bank SA and Bankia SA, two of Spain's larger banks.

## The Deal

Caixa Bank SA announced to acquire Bankia SA in a deal that values Bankia SA at about 3.8 billion euros(\$4.5 billion). The joint bank will deliver combined annual cost cuts and increased revenue of about 1.1 billion euros, as reported by Caixa Bank.

## Deal Motivation

The accord creates a lender with a combined market value of about 16.8 billion euros based on Thursday's share prices. It will be Spain's biggest bank by loans, assets and deposits, creating economies of scale that may allow it to undercut competitors in prices and would strengthen Caixa's leading domestic position and put some distance between Bankia vs Santander and BBVA, as the combined entity would have well more than 300 billion euros of loans in Spain. Based on deal disclosures, Caixa-Bankia will have a 25% share of lending in Spain, 24% in deposits and 29% in long-term savings (mutual funds, pension plans and insurance). Caixa's focus on Catalonia complements the network run by Bankia, which has a strong presence in Madrid. There is also to be significant branch overlap, which will deliver cost synergies. Caixa's strength in insurance and protection would also drive revenue synergies as reported by Bloomberg. Caixa Bank said it expects the acquisition to generate about 770 million euros of cost synergies a year and additional annual revenues of about 290 million euros. It expects its revenue to increase by 28% compared to market estimates for 2022 and the combined bank is expected to have a CET1 ratio of 11.6%(Bloomberg).

References:[1] Marek Badik, Motives and Reasons of the Bank Mergers in the EU, Silsian University in Opava, Czech Republic, 2010.

[2]Bloomberg Intelligence

## Student Spotlight



### Jiaojiao (JoJo) Spring – 19, MSF

**“You don’t have to be perfect. Striving for perfection can leave you feeling more stressed and anxious. Accept your imperfection and just try to give your best,”** says Jiaojiao

By Ruchi Agrawal

After completing her bachelor’s in International Marketing and obtaining FRM certification in 2017, JoJo moved to US from China in Spring 2019 for her masters to explore more and dig deeper into the subject of Finance. JoJo is a Derivative Risk Intern at Athene, Iowa, United States.

Attention to detail, learning from mistakes, continuous improvement and being open to change are some practices our ex- GPMC President and current Finance Trading Lab Manager Jiaojiao follows.

“Reach out to your professors and seniors. They are always there to help you each step of your way through your career”, says JoJo on how she managed to adjust beyond the sea and excel in both academics and extracurriculars.

As a tip on job/internship application process she recommends customizing the resume and cover letter for every company (at least target companies).”Go through the company’s 10k before an interview,” she added. She stresses on having an advanced knowledge of Excel and SQL and believes that accepting mistakes and learning from them is the key to success in any organization.

## Definition: SPACs

A Special Purpose Acquisition Company (SPAC) also called a blank check company, is a shell company with no operations but goes public with the intention of utilizing the proceeds of its Initial Public Offering to merge or acquire another company. Seen as an alternative to traditional IPOs, SPACs offer some technical advantage over the traditional IPOs, which involves investment banks, to companies seeking to go public.

## Quiz:

Where does the financial epicenter of America – Wall Street – get its name from?

- The Wall Street Journal.
- James Haverford Wall, who conceived the short-lived \$3 bill
- The Wooden wall built by Dutch colonists to defend New Amsterdam

Last quiz answer: Office of the Comptroller of Currency.

## Word Scramble:

- DTRUIERRNEW
- UONQSITAIC
- IOVSTRSNE
- UED LIGEECNID
- WLLA STEERT

Last Word scramble answer: Consolidation, Amortization, Mortgage, Premium, Liability

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