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EU Banks Selling 'Crown Jewels' for Cash

By Anne-Sylvaine Chassany, Kevin Crowley and Charles Penty - Dec 12, 2011

European banks, under pressure from regulators to bolster capital, are selling some of their fastest-growing businesses to competitors from outside the region -- at the expense of future profit and economic growth.

Spain's [Banco Santander SA \(SAN\)](#), Belgium's [KBC Groep NV \(KBC\)](#) and [Germany's Deutsche Bank AG](#) are accelerating plans to exit profitable operations outside their home markets. Santander, which said in October it needs to plug a 5.2 billion-euro (\$6.9 billion) capital gap, sold its Colombian unit last week to Chile's Corpbanca for \$1.16 billion. Deutsche Bank is weighing options including a sale of most of its asset-management unit, while KBC may dispose of businesses in Poland.

Such sales risk hurting long-term profit, just as [Europe](#) enters recession, investors say. It's the unintended consequence of the decision by European regulators to make banks increase core capital to 9 percent by June instead of 2019. Unwilling to raise equity because their share prices are too low, lenders are selling profitable assets because they're struggling to find buyers willing to pay enough for their troubled loans to avoid a loss that would erode capital. Investors say the sales risk leaving banks focused on a stagnant economy and deprive them of economic growth from outside the region.

"These are the most profitable parts of their business," said Azad Zangana, European economist at London-based Schroders Plc, the 200-year-old British asset manager, citing Spanish and Portuguese banks selling assets in [Latin America](#). "They're being forced by regulators to sell them off. You begin to become a less profitable organization. Your business model stops working if you're being forced to lend only to an economy that's going through a very deep recession."

Hurting Profitability

The divestitures are likely to hurt banks' profitability in coming years, analysts say. Shrinkage will cut their return on net asset value by 1.5 percentage points on average, according to a Dec. 6 report by Huw van Steenis, a Morgan Stanley analyst in [London](#). Return on asset value at Frankfurt-based Deutsche Bank will shrink by almost 1 percentage point and at Santander by about 0.8 percentage point because of deleveraging, he said. The shrinking economy will help cut returns by an additional 2.5 percentage points, he added.

'Cheaper Way'

For French banks [BNP Paribas SA \(BNP\)](#), [Societe Generale \(GLE\)](#) SA and [Credit Agricole SA \(ACA\)](#), return on equity may fall to between 7 percent and 9 percent in 2013, from 12 percent to 21 percent in 2007, according to Christophe Nijdam, an analyst at AlphaValue in Paris. The ratio may rise to between 10 percent and 12 percent by 2015, assuming the economy recovers by then, he said.

"There's nothing wrong in theory about selling the crown jewels," Nijdam said. "It's always a question of price. European banks will be less profitable -- but less risky."

For banks, selling assets has become a cheaper way to raise capital than selling new stock after their shares tumbled. The [Bloomberg Europe Banks and Financial Services Index \(BEBANKS\)](#) has slumped 33.5 percent this year, leaving bank stocks trading at an average of 63 percent of book value.

"Many of those banks are trading at 50 percent of their book value, so if you can sell an asset at more than that, it's a cheaper way to raise capital," said Symon Drake-Brockman, former chief executive officer of [Royal Bank of Scotland Group Plc \(RBS\)](#)'s global banking and markets in the Americas and now managing partner of private-equity firm Pemberton Capital Advisors LLP in London.

'Adverse Selection'

Banks across Europe have pledged to sell more than 950 billion euros of assets over the next two years, according to data compiled by Bloomberg. About two-thirds of that will come from sales of profitable units and performing loans, said van Steenis. Sales of distressed assets and souring loans will account for just 4 percent, or about 100 billion euros, he said.

"European banks are likely to sell good, performing assets to foreign banks and investors," he said in an interview. "The question is: When are you getting to the point of adverse selection? When you're selling the good assets and you're keeping the more risky assets. There is a risk we're moving in that direction."

Buyers, for the most part private-equity and hedge funds, are offering too steep discounts for underperforming assets. For banks, a fire sale would trigger losses they can ill afford at a time when they're required to boost capital.

"Lenders are selling more liquid assets so they can get a price that avoids additional capital losses," said Joseph Swanson, co-head of restructuring at Houlihan Lokey in London.

"Unfortunately, this strategy can result in lower asset quality and increased earnings volatility."

Raising Capital

Regulators are forcing European banks to raise capital as the region's sovereign-debt crisis worsens. The [European Banking Authority](#) last week ordered the region's financial firms to raise 114.7 billion euros of additional capital. The EBA, which co-ordinates the work of the region's 27 national regulators, told lenders to bolster their core Tier 1 capital ratios to more than 9 percent of risk-weighted assets by the middle of 2012.

Faced with a potential credit crunch, the regulator told banks to raise the money from investors, retained earnings and lower bonuses. Failing that, companies may sell assets, provided the disposals don't limit overall lending to the European Union's "real" economy, the EBA said in a Dec. 8 statement.

Santander, KBC

Santander completed the sale of its Brazilian insurance operations to Zurich Financial Services AG for \$1.7 billion and sold a \$958 million stake in Banco Santander Chile, the South American country's biggest bank by assets. The Chilean bank's net profit grew [45 percent \(BSAN\)](#) between 2008 and 2010 and may increase by another 15 percent this year to about \$970 million, according to analyst estimates compiled by Bloomberg. Santander said it will also sell a stake in its Brazilian banking unit.

The Spanish lender's sale of its U.S. consumer-loan business to a group led by private-equity firm KKR & Co. may cut net profit for Santander's shareholders by 150 million euros, according to an Oct. 28 estimate by Raoul Leonard, an analyst at RBS in London.

"That may only equate to 2 percent of Santander's group net attributable profit for 2010, but assuming multiple asset sales may be in the pipeline, this could lead to a meaningful negative drag on" earnings, Leonard wrote.

A spokeswoman for Santander, who asked not to be identified by name in line with company policy, declined to comment.

KBC, the Belgian bank that received a 7 billion-euro government bailout, said in July it would sell Towarzystwo Ubezpieczen i Reasekuracji Warta SA, [Poland's](#) second-largest insurer, and its 80 percent stake in Polish bank Kredyt Bank SA.

Kredyt Bank

The sale of Kredyt Bank, whose net income rose 9.5 percent to 60.8 million zloty (\$17.6 million) in the third quarter, will reduce KBC's return on equity to 17.3 percent from 18.9 percent, according to Benoit Petrarque, an analyst at Kepler Capital Markets in Amsterdam.

If the disposal isn't big enough to help meet the 9 percent capital target, the bank could sell its Czech unit as well, Petrarque said. The sale of the Czech division would boost core capital to 10.5 percent at the cost of reducing return on equity to about 11 percent, he estimated. KBC said in July it would retain full ownership of Czech banking unit CSOB AS, its most profitable business in Eastern Europe.

"When you sell an asset, there are always two sides of the coin," Stephane Leunens, a spokesman for KBC, said in a telephone interview. "We focus on de-risking the company while trying to generate sufficient growth in our core markets."

'Less Global'

Philippe Bodereau, head of European credit research at Pacific Investment Management Co. in London, said in a telephone interview that European banks are becoming "slimmer, less global" and "more utility-like." They will be "better credit investments than equity investments," he said.

Deutsche Bank, which needs to plug a 3.2 billion-euro capital shortfall by the middle of next year, said last month it is reviewing all options, including a sale, for most of its asset-management unit, a business that CEO Josef Ackermann built up over the last decade to help mitigate the bank's reliance on investment banking.

The review focuses on "how recent regulatory changes and associated costs" are affecting the business, Deutsche Bank said in the Nov. 22 statement. The disposal would exclude the DWS mutual fund unit in Germany, Europe and [Asia](#), which the bank said was "a core part" of its offering to consumers. The review will be conducted "thoroughly and carefully" said Deutsche Bank spokesman Klaus Winker, declining further comment.

Portuguese Sales

Banco Espirito Santo SA, Portugal's largest publicly traded lender, sold its stake in [Brazil's Banco Bradesco SA \(BBDC4\)](#) for about \$1 billion and part of its stake in Denmark's Saxo Bank A/S this year. [Banco Comercial Portugues SA \(BCP\)](#), the country's second-biggest bank by market value, is considering options for Bank Millennium SA, Poland's seventh-largest lender, including a sale. The Porto-based lender needs to raise 1.7 billion euros to meet regulatory targets.

The Bradesco sale doesn't affect the operation's performance in Brazil and the bank's loan portfolio in that country is growing, Paulo Padrao, a spokesman for Espirito Santo said. Banco Commercial aims to "extract the maximum value" out of operations in Central and Eastern Europe, Erik Burns, a spokesman for the bank, said.

[ING Groep NV \(INGA\)](#), the Netherlands's biggest financial-services firm, agreed in July to sell most of its Latin American insurance unit for about 2.6 billion euros to a group led by Grupo de Inversiones Suramericana SA, a Colombian investment firm.

“If they raise capital by selling crown jewels, the market will reward them in the short term because they’ll meet the regulator’s timeframe,” said Will James, who runs the 632 million-pound SLI European Equity Income Fund at Edinburgh-based Standard Life Plc. “That begs the longer-term question: How do you grow in an environment where customers are unwilling to borrow. That’s the missing piece from the puzzle. In a low- growth or no-growth environment, banks that have sold good assets will continue to struggle.”

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