

A season of Mergers & Acquisitions

- Recently, there have been whispers of a possible merger between Zenith and Union bank. This comes after a merger between Access Bank Plc and Diamond Bank Plc in 2018. For us, we believe a merger between both banks will make the combined entity the largest bank in Nigeria with an asset size of ₦8.2 trillion or \$22.5 billion.
- **Where Union Bank is coming from:** Over the last four to five years, Atlas Mara has gradually increased its stake in union bank, which now stands at 49% (following the rights issue in 2017). Within this period, with the help of Atlas Mara, management successfully reduced union bank's NPL ratio to 5.8% as FY 19 (FY 18: 7.8%, FY 17: 20.8%) and returned the bank's retained earnings to ₦21.4 billion as at FY 2019 (after recording eight consecutive years of negative retained earnings). Accordingly, Union bank was able to propose a final dividend of ₦0.25/share to shareholders for FY 2019.
- **Why we see a possible deal:** For us, the successful completion of the merger will only reinforce Atlas Mara's long-term strategic play in the Nigerian financial services sector. For clarity, an all equity transaction would mean the company will have a stake in a more solid company like Zenith bank. And a cash transaction will could be at a premium, given the recent recovery in Union bank. Using a precedent transaction valuation of Access + Diamond bank, we estimate an equity value of ₦419 billion for Union Bank with an implied transaction multiple (P/B) of 1.7x. Our estimate factors a premium of 210% which was applied to the P/B multiple of Diamond bank at the time of transaction.
- **What does Zenith bank stand to gain?** A merger/acquisition would see Zenith bank become the largest bank in Nigeria. It would help the bank expand its footprint and gain market leadership in the industry. Aside that, we struggle to see any other benefits to Zenith bank given its already strong position in the industry. Zenith has a large buffer to cater for the acquisition with ₦671 billion (\$1.8 billion) in Cash and cash equivalents as at Dec 2019.
- **What should Investors do?** Depending on the mode of transaction, an all cash merger could see shareholders of UBN get cash payments from Zenith bank at a premium to respective stakes in UBN. However, this has a limitation as tax charges would eat into the payment. On the other hand, an all equity merger would make shareholders benefit from having a stake in a solid bank like Zenith bank without incurring tax charges. Similarly, shareholders of Union could also get a premium value relative to their respective stake in UBN.