Company Spotlight: BNP Paribas

BNP Paribas has agreed to take control of Fortis's operations in Belgium and Luxembourg, as well as its international banking franchises, for a total consideration of E14.5 billion.

This transaction provides BNP Paribas with the opportunity to roll out its integrated banking model further in Europe. As a result of this transaction, BNP Paribas will have two new domestic markets, Belgium and Luxembourg, to add to its existing domestic markets in France and Italy.

The businesses acquired consist of Fortis's operations, excluding those in the Netherlands, which have been acquired by the Dutch government. In particular, the acquired operations include: 1,458 branches located in Belgium, Luxembourg and all other countries in which Fortis is present except the Netherlands, as well as the Fintro branch network in Belgium; an insurance business, also in Belgium; investment management activities, including former ABN Amro Asset Management; and all private banking businesses, merchant banking activities and consumer finance activities outside the Netherlands.

Following the acquisition by the Dutch government of Fortis Bank Nederland Holding, including Fortis's interest in ABN Amro Holding and Dutch insurance activities, the Belgian government will raise its stake in Fortis Bank Belgium to 100%.

Under the terms of the transaction, BNP Paribas will then acquire 75% of Fortis Bank from the Belgian government and 100% of Fortis Insurance Belgium, and acquire 16% of Fortis Banque Luxembourg from the Luxembourg government, taking its controlling interest in Fortis Banque Luxembourg to 67%.

The total consideration for the transaction will be E14.5 billion. BNP Paribas will acquire its interest in Fortis's banking business in Belgium and Luxembourg for E9 billion, paid as approximately 132.6 million newly-issued BNP Paribas shares. Fortis Insurance Belgium will be acquired for a cash consideration of E5.5 billion.

As a consequence, the Belgian and Luxembourg states will become shareholders of BNP Paribas, with stakes of 11.6% and 1.1%, respectively, and Belgium is expected to appoint two new members to join the BNP Paribas board. The Belgian government's stake will be subject to a two-year lock-up for up to 10% of BNP Paribas's capital. The 50% stake owned by Luxembourg will be subject to a lock-up period of one year.

BNP believes that this acquisition will reinforce its diversified and balanced business mix, with retail representing 57% of the group's pro forma revenues.

The agreement for the purchase of the acquired businesses has been signed and closing is subject to antitrust and regulatory approvals. 88 million shares will be issued pursuant to the standing authorization granted to the BNP Paribas board, while the issuance of a further 44 million will be submitted to an extraordinary general meeting of BNP Paribas shareholders. Closing is expected to take place by 2008 year-end or in the first quarter of 2009.

Business Description

BNP Paribas (BNP) is a leading European bank. The company specializes in retail banking, corporate and investment banking, and asset management. It has a large international banking network, spread across Europe, Asia and the US.

BNP has five operating segments: corporate and investment banking, international retail services, French retail banking, asset management services and BNL banca commerciale (Italian retail banking). Non operating activities are assembled under the category 'others'.

The corporate and investment banking division offers services in equities and derivatives, fixed income, corporate finance, energy commodities export project, structured finance, cash management, and loan and portfolio management. These services are provided to companies, institutions, states and public authorities. The corporate and investment banking segment operates in two divisions: advisory and capital markets, and financing business. Advisory and capital markets business is further segregated as equities and derivatives, fixed income and corporate finance. Financing business is arranged under specialized finance and structured finance activities.

The international retail banking and financial services segment was renamed as international retail services in April 2008. The segment includes BNP's specialized financial services and international retail banking operations. International retail banking covers retail banking in the US and in selected emerging markets. In the US, the group operates BancWest Corporation. It also has presence in Europe, Africa, Mediterranean basin and the Persian Gulf. Specialized financial services encompass consumer finance, equipment solutions and private mortgages.

French retail banking offers products and services such as current account services and more complex financial engineering services, in the corporate financing and asset management sectors. The retail network operated by this segment in France comprises 2,200 branches, 4,900 ATMs and 222 private bank centers. The customer base of the French retail banking segment comprises six million individual clients, 500,000 entrepreneurs and small business clients, and 22,000 corporate and institutional clients.

The asset management and services division offers fund management and discretionary asset management services, backed by a range of high value-added investor services. The main areas covered by AMS involve wealth and asset management, insurance, and securities services. Wealth and asset management comprises BNP Paribas Private Bank, BNP Paribas Investment Partners, BNP Paribas Personal Investors and BNP Paribas Real Estate. BNP operates in the insurance sector through BNP Paribas Assurance, which is one of the largest global players in creditor insurance. Through BNP Paribas Securities Services, AMS provides securities services to corporate clients, fund managers and financial institutions across the globe.

BNL banca commerciale (BNL) is a new segment formed in 2006. It emerged from the reorganization of the BNL Group in Italy after it was acquired by BNP in 2006. BNL provides commercial banking services in Italy to individual and private banking clients, small and medium sized companies, and territorial authorities. BNL offers a range of products and services designed to meet a variety of clients needs ranging from financing, savings products and transactions, and private banking. BNL also operates 1,300 ATMs and 20,000 point of sales, as well as telephone and online banking services for both private clients and businesses.

Other activities mainly comprise the private equity business of BNP Paribas Capital, the Klepierre property investment company, and the group's corporate functions. Klepierre is a real estate investment company. It develops, owns and manages shopping centers in 10 European countries including France, Spain and Italy. Klepierre also owns and manages high quality office premises in Paris and its inner suburbs.

Key facts	
Address	BNP Paribas Group 16 Boulevard des Italiens Paris 75009 FRA
Website	www.bnpparibas.com
Telephone	33 1 40 14 45 46
Paris ticker	BNP
Employees	162,700
Turnover (Em)	31,037
Financial year end	December

Major products & services
Retail banking
Mortgage financing
Asset financing
Cash management
Corporate loans
Equities and derivatives
Corporate and investment banking
Insurance solutions
Fund management services
Commercial banking services
Real estate investment

SWOT Analysis

BNP is one of the world's leading banking and financial services groups, with extensive international coverage and strong positions in all major financial centers. It operates in 85 countries covering five continents, specializing in finance, investment banking, international private banking and asset management. BNP's strong operations in France facilitate a direct link with customers and increase the group's market penetration opportunities. However, the increasing interest rates and sub-prime problems may adversely affect the group's profitability.

Table: SWOT Analysis

Strengths	Weaknesses
Leading market position	Increasing cost of risk
Growing international operations	Weak Tier I ratio
Brand strength	
Opportunities	**Threats**
Opportunities in Chinese banking industry	Weak anti-fraud controls at BNP Paribas Private Bank
Growing demand for retail banking in emerging markets	Effect of exposure to sub-prime
Launch of mobile contactless payment system	
Source: Datamonitor	

Strengths

Leading market position

BNP has a leading market position across geographies and business segments. The group is the largest bank in France and the fifth largest bank in the world according to Forbes April 2008 report. In the same report, Forbes named the group as the 13 largest company in the world. With a network of 2,200 branches and 4,900 automatic cash dispensers, BNP has a strong retail banking operations in France. The division enjoys a 15% share of the greater Paris market. It also has a strong presence in the personal banking market, with a market share of 22% among the households with net annual revenues in excess of E82,000. The group also has substantial presence in Italy through BNL banca commerciale.

It is the leading equipment leasing financer in France with an 18.6% market share. Outside Europe, the group has substantial presence in the US through BancWest, which is the fifth-largest bank in the country based on deposits. BNP's corporate and investment banking division ranks in the top 10 across a number of product segments. For instance, in 2007, Dealogic ranked BNP as the third largest global mandated lead arranger, and Thomson Financial ranked the group as a leader in the Europe, Middle East and Asia region. The group's leading market position confers it a significant competitive advantage over its competitors in attracting new customers.

Growing international operations

BNP has strong international presence, as evident from its international revenues. Over a short period, the group has been successful in establishing an admirable retail banking network in various geographies. In less than five years (2003–2007), the international retail services segment has doubled in size, both in terms of the number of employees (from 29,000 to 71,000) and customers (28 million to more than 50 million). Over the period its revenues have risen from E4.9 billion to E8 billion and its presence has expanded to 60 countries. The unit's geographic balance has also changed, as fast-growing emerging markets represent a greater proportion of overall activities and the number of countries where all the businesses operate has also increased. In 2008, the group reorganized the internal structure of its international retail operations for deploying its operating model across all countries, with closer coordination between its branch banking networks and retail financial services. The focus of the reorganization was to expand the client franchise, pursue cross-selling, deploy new sales models and strengthen operational efficiency. BNP Paribas's international retail services business strengthens its leading positions in each of its businesses and markets, and in the process increases revenues and profits for the group.

Brand strength

BNP is a leading global brand. The group's brand was ranked seventh in the Global 500 Financial Brands Index reported by Brand Finance, with an estimated value of $14.6 billion in 2007, a one place improvement over 2006. According to Brand Finance, BNP was the sixth most valuable brand in the international banking world, excluding American Express. The report ranks BNP among the top five brands in retail banking, with a brand value of $8.5 billion. Furthermore, Brand Finance has upgraded its rating of BNP Paribas from A to A+. In addition to Brand Finance, BNP was also recognized as a leading brand by other surveys in Europe. A Financial Times survey recognized BNP as the number one investment bank in continental Europe and a survey by Euromoney placed the company as the second-leading private bank in Eurozone. Furthermore, with a credit rating upgrade to AA+ by Standard & Poor's in June 2007, BNP joined the elite group of banks worldwide which can boast of great financial strength. The group's strong brand value indicates the reliability and acceptance of its products and services.

Weaknesses

Increasing cost of risk

'Cost of risk' represents the net amount of impairment losses recognized in regards to credit risks inherent in the group's banking intermediation activities, plus any impairment losses relating to counterparty risks on over-the-counter derivative instruments. The group's cost of risk increased from E610m in 2005 to E783m in 2006. However, in 2007, the cost of risk jumped to E1,725m, more than double provision compared to the previous year. The increase was contributed in part to the write downs related to sub-prime loans. For the first quarter of 2008, provisions for risky loans more than doubled from a year earlier to E546m, including E186m related to sub-prime. Provisions for US consumer banking operations and corporate and investment banking operations form the major portion of the risks due to tough markets. As a result, the cost of risk continues to rise, denting the group's profits.

Weak Tier I ratio

The bank's Tier 1 capital coverage of risk weighted assets has been continuously declining since 2003. BNP's Tier 1 ratio fell from 9.4% at the end of 2003 to 7.3% at the end of 2007. BNP's Tier 1 ratio is low when compared to its competitors, Credit Agricole (8.1%) and HSBC (9.3%). Although the group was able to avoid the worst of the sub-prime mortgage market crash, it was one of the first financial groups to feel the effects of the subsequent credit crunch. In August 2007, the group froze three funds, as it could not sell those securities at reasonable prices, although the funds were reopened later. In the current market place, a low and continuously declining Tier 1 ratio puts BNP's operations at a greater risk and is far from reassuring creditors of the group's credibility.

Opportunities

Opportunities in Chinese banking industry

Established in China at the beginning of the 1980s, BNP has undergone constant expansion in the region. In 1992, the group set up a branch in Shanghai, 50/50 owned with ICBC, and purchased the ICBC shares in 2003. Then, at the end of 2005, BNP further strengthened its presence in China, in retail and financial banking, by acquiring 19.2% of Nanjing City Commercial Bank, the eighth largest commercial bank in China, with 58 branches, 1.2 million personal clients and 60,000 corporate clients. In October 2006, BNP launched a private bank in Shanghai. During this time, 250,000 Chinese had incomes over $1m and that number was growing. In 2008, BNP showed interest to open corporate and investment banking operations in China. The group plans to double its workforce of 325 in China (as of June 2008) and triple its revenue from the country in three years. Corporate and investment banking operations in China have been profitable for foreign operators and the domestic deposit base of $2.8 trillion has been luring many foreign banks into the country. Increasing presence in China is expected to raise revenue from BNP's Asian operations, and would offset the lower market growth rates in Europe and the US.

Growing demand for retail banking in emerging markets

In the next 25 years, a major portion of the increase in world demand is expected to come from BRIC countries, as well as other developing markets. BNP is in a good position to capitalize on these markets. The group's emerging markets retail banking networks underwent significant growth in 2007, with 670 branches opened in their customer territory, covering 34 countries. The business has developed rapidly since 2004, and now consists of five times more branches and four times more clients. In 2007, the group opened 187 branches, 103 of which were in Turkey, 50 in North Africa and 13 in the near and Middle East. It also invested in the organic development of a local bank network in Russia. Due to the group's focus on emerging markets, the contribution of emerging markets to the group's top and bottom lines is expected to rise at healthy rates.

Launch of mobile contactless payment system

BNP, along with five other French banks and four mobile operators, associated with MasterCard Worldwide and Visa Europe to launch, at the end of November 2007, a large-scale field trial to test mobile contactless payment systems in the cities of Caen and Strasbourg. This new multi-operator payment service, named 'Payez Mobile', aims to simplify proximity payments, and offers an improved mechanism to handle everyday transactions. Payez Mobile is the first step toward a commercial roll-out of a new payment solution. If Payez Mobile is accepted in the field trial, it will bring BNP much visibility, as mobile contactless payment is also a step towards bringing the required standardization within the future Single Euro Payments Area (SEPA). SEPA is the next major step towards closer European integration. The implications of SEPA is that all retail payments in Euro will eventually become 'domestic', and there will no longer be any differentiation between national and cross border payments within the Eurozone. BNP's involvement in Payez Mobile reinforces its market dominance in the French banking sector.

Threats

Weak anti-fraud controls at BNP Paribas Private Bank

In May 2007, the Financial Services Authority (FSA), the UK's financial services regulating body, fined BNP Paribas Private Bank (BNPP Private Bank) £350,000 for weaknesses in its systems and controls that permitted a senior employee to fraudulently transfer £1.4m out of clients' accounts. FSA reported that it was the first time a private bank had been fined for weaknesses in its anti-fraud systems. The FSA found that BNPP Private Bank did not have an effective review process for large transactions, over £10,000, from clients' accounts. It also found that the bank's procedures were not clear about the role of senior management in checking significant transfers prior to payment. As a result, a number of fraudulent transactions were not independently checked. In addition, a flaw in the bank's IT system allowed the senior employee to evade the normal middle office processes. This meant that basic authorization and signatory checks were not carried out on internal cash transfers between different customer accounts. Weak anti-fraud controls could lead to customer defection.

Effect of exposure to sub-prime

In 2004 and 2005, when the US housing market was on the rise, many banks provided funds to borrowers with low credit-worthiness. With the slow down of housing market in 2006 and 2007, these borrowers are finding it difficult to repay the loans resulting in increase in defaults. The US sub-prime mortgage crisis not only affects the financial institutions in US but also many financial institutions around the world. This has resulted in spillover of the US sub-prime mortgage woes around the world. A majority of BNP's investment in mortgage related securities is exposed to this crisis. In August 2007, the group froze E2 billion worth of funds as defaults on sub-prime loans, or those made to people with poor credit rose sharply since the second quarter of 2007. As a result, several investors have been withdrawing the money they had invested. The world's biggest financial institutions reported $335 billion of markdowns and credit losses since 2007. Although the group has dogged the worst crisis it was forced to write down assets at its investment bank by E514m in 2007. Moreover, due to the sub-prime mortgage crisis, banks in the US, including BNP, are finding it difficult to raise funds as the securitized products are not in demand. US sub-prime woes could negatively impact the financial performance and position of the group in the coming quarters.