60. Acquisition/Merger of Euro Bank, S.A.

Description of the transaction

On 5 November 2018, Bank Millennium (acquiring entity) announced and signed the preliminary agreement related to the acquisition of 99.787% shares of Euro Bank S.A. (acquired entity) from SG Financial Services Holdings ("Seller"), a wholly owned subsidiary of Societe Generale S.A. The transaction specified in the agreement is the direct acquisition of the shares by Bank Millennium.

The strategic rationale for the transaction

As a result of the transaction related to the acquisition of Euro Bank shares, Bank Millennium strengthened its important position in the Polish banking sector. The transaction increased the number of the Bank's clients by 1.4 million (of which more around 494 thousand fulfil the classification of active client as per Bank's internal definition) and therefore allowed the Bank to become one of the largest Polish bank in terms of the number of retail clients.
The acquisition of Euro Bank allowed the Bank to increase the segment of consumer loans, as well as the importance of this segment for the entire Group.

The acquisition of Euro Bank enabled Millennium Bank to acquire competences in the franchise model and strengthen its presence in smaller cities, where Euro Bank was strongly located, and contributed to increase of the geographical coverage of the Bank's distribution network.

Price

The parties to the contract have determined the price for the purchase of Euro Bank SA shares in the amount of PLN 1,833,000,000 (Euros 428,151,000), which is subject to the adjustment mechanism after closing the transaction (i.e. after transferring the legal title to the shares to Millennium Bank). At the date of preparation of the financial statements as at 31 December 2019 the preliminary price after adjustments amounted to PLN 1,816,545,000 (Euros 424,307,000) and was calculated on the basis of audited net asset value of Euro Bank as at 31 May 2019. The final price to be paid by Millennium Bank for the shares may differ from the price indicated above.

Bank Millennium did not increase the share capital in order to finance the Transaction.

Financing

The acquisition (price in the amount of PLN 1,833,000,000 (Euros 428,151,000)), according to the agreement, was paid with cash and was financed from the internal means of the Bank. Additionally, the Agreement specified that the financing for Euro Bank from Societe Generale (including subordinated debt to SG), would be paid or refinanced by Euro Bank or Bank Millennium.

Completion of the acquisition

On 3 January 2019, the Bank received information on issuing by the President of the Office of Competition and Consumer Protection the decision on the consent for the concentration consisting in the Bank's acquisition of control over Euro Bank S.A. The consent was issued on 28 December 2018.

On 28 May 2019 the Polish Financial Supervision Authority issued the consent specifying that there is no basis for the objection raising, and therefore Bank Millennium together with its parent entity, Banco Comercial Português, S.A., were allowed to acquire the shares of Euro Bank S.A. in the number resulting in exceeding 50% of the total number of votes on the general meeting of Euro Bank and of the share in the share capital. The number of acquired shares exceeding 50% results also in becoming a parent entity of Euro Bank.

On 31 May 2019, by executing the share purchase agreement between the Bank and SG Financial Services Holdings of 5 November 2018, the Bank has acquired the majority of shares, constituting 99.787% of Euro Bank S.A. share capital from the seller.

Additionally, on 31 May 2019, the Bank has repaid the unsubordinated financing granted to Euro Bank by Societe Generale S.A. ("SG") in the amount of ca. PLN 3.800.000.000 (Euros 887,602,000). It was preceded by Euro Bank's repayment of a part of subordinated debt from SG in the amount of PLN 250.000.000 (Euros 58,395,000), after obtaining appropriate agreements from the PFSA in this particular area. In October 2019, a final repayment of a subordinated loan of SG taken out by Euro Bank in the amount of PLN 100 million (Euros 23 million) (fully collateralised by a cash deposit since 31 May 2019) took place.

In order to limit the risk associated with the Euro Bank's portfolio of mortgage loans denominated in CHF or denominated in PLN, but indexed to CHF, Euro Bank and SG signed on 31 May 2019 an "CHF Portfolio Indemnity and Guarantee Agreement" as it was planned in the Share Purchase Agreement. Euro Bank, Bank Millennium and SG also concluded an agreement related to the provision of certain limited transitional services by SG for Euro Bank.

Merger plan

On 6 June 2019, the Management Board of Bank Millennium and the Management Board of Euro Bank agreed and signed the merger plan of Bank Millennium and Euro Bank (the "Merger"). The merger was performed in accordance with art. 492 § 1 point 1 of the Commercial Companies Code (KSH) by transferring all assets and liabilities of Euro Bank (the acquired bank) to Bank Millennium (the acquiring bank), without increasing the share capital of Bank Millennium.

In accordance with the Merger, existing, dematerialized shares of Bank Millennium ("Merger Shares") were allocated to the minority shareholders of Euro Bank. The shares were purchased on Warsaw Stock Exchange S.A. in the secondary trading, by Millennium Dom Maklerski S.A. [Millennium Brokerage House], by the order of Bank Millennium, pursuant to art. 515 § 2 of the Commercial Companies Code.

The following share exchange parity has been determined in the Merger Plan: in exchange for 1 (one) share of Euro Bank, a minority shareholder of Euro Bank received 4.1 Merger Shares.

As a result of the Legal Merger performed 1st October 2019, Bank Millennium assumed all the rights and obligations of Euro Bank, and Euro Bank was dissolved without liquidation proceedings and its entire assets were transferred to Bank Millennium. The merger took place on the day of its entry into the register of entrepreneurs of the National Court Register of Bank Millennium.

The merged Bank operates under the name Bank Millennium S.A. based on the provisions of the Act of 15 September 2000 - Code of Commercial Companies ("KSH").

The merger was performed based on already obtained appropriate consents and permits required by law, i.e.:
(i) - permission of the Polish Financial Supervision Authority ("PFSA") for the Merger, pursuant to art. 124 paragraph 1 of the Act of 29 August 1997 - Banking Law ("Banking Law");
(ii) - permission of the PFSA to amend the Statute of Millennium Bank pursuant to art. 34 paragraph 2 of the Banking Law.

Provisional Transaction settlement

Transaction settlement was performed applying the acquisition method, in accordance with the International Financial Reporting Standard 3 "Business combinations" ("IFRS"), which requires, among others, recognition and measurement of identifiable assets acquired, and liabilities assumed measured at fair value as at the acquisition date, and any non-controlling interest in the acquired entity (if any) and separate recognition and measurement of goodwill or gain on bargain purchase.

Considering that acquiring control over Euro Bank S.A. occurred on 31 May 2019, the provisional settlement of the Transaction was based on the data from the acquired company as at that date, considering the adjustments required by IFRS 3. The zloty to euros conversion rate used was the reference rate as at 31 May 2019, i.e. 4.2812.

As part of the transaction, the Group identified non-controlling interests amounting to 0.2% of the total value of Euro Bank shares. Bank Millennium acquired 26,240 shares of the Bank, constituting 0.00216302% of its share capital, which were then offered as merging shares to authorized shareholders of Euro Bank other than the Bank. The average purchase price of one merger share was PLN 5.939842, and the total price, representing the total cost of purchasing the merger shares, was PLN 156.000.

During the settlement of merger, in which the Group acts as the acquirer, the acquisition method of acquisition is applied, according to IFRS 3 "Business Combinations".

In case of each acquisition, the acquirer and the acquisition date are determined. Acquisition date is the date when the entity acquired control over the entity being acquired. In addition, the acquisition method requires recognition and measurement of identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquired entity, as well as recognition and measurement of goodwill or bargain purchase gain. The acquirer measures the identifiable assets acquired and liabilities assumed at their fair values as at the acquisition date.

If the net amount of fair values of identifiable assets acquired and liabilities assumed exceeds the fair value of the consideration transferred, the Group, as the acquirer, recognizes the gain on bargain purchase in profit or loss. Before recognizing the gain from a bargain purchase, the Group reassesses whether all the acquired assets and liabilities assumed have been correctly identified and all additional assets and liabilities have been recognized.

If the value of the consideration transferred, measured at fair value as at the acquisition date, exceeds the net value of fair values of identifiable acquired assets and liabilities assumed as at the acquisition date, the goodwill is recognized. The determined value of goodwill is not subject to amortization, but at the end of each financial year and whenever there are impairment triggers identified, it is tested for impairment.

The profit and loss account of the Group includes the result generated by Euro Bank since the purchase of shares, i.e. from 31 May 2019 until the legal merger on 1 October 2019.

Payment transferred in the acquired entity

	Identifiable assets acquired and liabilities assumed measured at fair value	
	thousands of zloty	thousands of euros
Price transferred in accordance with the Agreement	1,833,000	428,151
Preliminary price adjustment	(16,455)	(3,844)
Price after adjustment	1,816,545	424,307

Payments for shares was a cash payment.

The preliminary price adjustment results from the changes and detailed arrangements made in accordance with the provisions of the Transaction Agreement and has not been settled yet as at 31 December 2019.

The Group made a provisional settlement of the merger and calculation of goodwill in connection with the purchase of Euro Bank S.A. shares. In accordance with the requirements of IFRS 3, The Group will perform the final settlement of the acquisition within a maximum period of one year from the date of acquiring the control (31 May de 2019). During this time, the acquirer may adjust retrospectively the provisional fair values of assets and liabilities recognized as at the acquisition date to reflect any new information obtained in relation to facts and circumstances that existed as at the acquisition date and, if known, would affect the measurement of those assets and liabilities. Such adjustments refer to the recognized goodwill or gain on bargain purchase.

This provisional purchase price allocation has been prepared by the Bank's Management Board based on calculations resulting from the concluded Transaction Agreement. The final settlement in accordance with the terms of the Transaction Agreement will, however, be subject to final arrangements between Bank Millennium and SG Financial Services Holdings, disposing the shares of Euro Bank S.A.

Recognition and measurement of identifiable assets acquired liabilities assumed measured in accordance with IFRS

The following data regarding the fair value measurement of the acquired assets and assumed liabilities were based on the identification from the point of view of Bank Millennium and the adopted assumptions regarding the materiality threshold.

	Identifiable assets acquired and liabilities assumed measured at fair value	
	million of zloty	million of euros
Assets		
Cash and deposits at Central Banks	242	57
Loans and advances to credit institutions repayable on demand	85	20
Financial assets at amortised cost		
Loans and advances to customers	12,594	2,942
Financial assets at fair value through profit or loss		
Financial assets not held for trading mandatorily at fair value through profit or loss	18	4
Financial assets at fair value through other comprehensive income	1,385	324
Other tangible assets	113	26
Goodwill and intangible assets	49	11
Deferred tax assets	135	32
Other assets	72	16
Total Assets	14,693	3,432
Liabilities		
Financial liabilities at amortised cost		
Resources from credit institutions	4,087	955
Resources from customers	7,975	1,863
Non subordinated debt securities issued	506	118
Subordinated debt	100	23
Hedging derivatives	6	1
Provisions	1	-
Other liabilities	364	85
Total Liabilities	13,039	3,045
Total Equity	1,654	386

Both the balance sheet amounts of Euro Bank S.A. as at 31 May 2019, as well as the amount of fair value adjustment of these items may change in the course of final transaction settlement what may affect the value of goodwill recognised within the Transaction.

The adjustments to the fair value for temporary differences constituted the basis for the calculation of deferred tax (recognised in the amount of PLN 33,800,000 (Euros 7,895,000)).

The portfolio of loans and advances to customers acquired as part of the Transaction related to the purchase of shares of Euro Bank S.A. as at the acquisition date, measured at fair value, was presented in the financial statements in net value.

Fair value measurement methods

Performing loans and advances to customers

The portfolio of loans and advances to customers acquired as part of the Transaction related to the purchase of shares of Euro Bank S.A. was measured at fair value as at the acquisition date in accordance with the requirements of IFRS 3 and IFRS 13. The fair value was determined using the present value technique of discounting future cash flows resulting from the acquired assets, considering expectations on possible fluctuations in the amount and timing of cash flows, the time value of cash flows and other factors that market participants would consider in similar circumstances.

The measurement of portfolio components was based on the following assumptions:

1. For each asset, the parameterization of the valuation model was determined based on its individual characteristics. For assets included in stage 1, contractual future cash flows were subject to provision for the effect of prepayments. In the absence of contractual cash flows, future capital flows were estimated based on the pace of debt repayment resulting from the statistical-behavioural model. For the exposures in stage 1, the real capital and interest flows were subject to adjustment for the impact of credit risk parameters.

2. Future interest flows for performing loans were determined based on the curve of forward rates for components related to the variable rate. Future values of the variable rate were determined on the basis of a yield curve constructed from financial instruments indexed to a given reference rate.

3. For performing loans with a payment schedule in the valuation model, contractual cash flows were subject to adjustment for prepayment factors.

4. For performing loans without contractual maturity date, future cash flows were estimated in the behavioural life cycle of the product. This concerned the portfolio of credit cards and the portfolio of current account limits.

5. For performing loans, capital-interest cash flows determined in previous steps were subject to adjustment for the PD and LGD parameter vectors throughout the lifetime of the exposure. In this way, the impact of credit risk on fair value was taken into account in the valuation model for exposures included in stage 1.

6. The fair value of the exposure was determined by discounting the expected future cash flows. The discount rate components were the following: zero-coupon rate derived from the right yield curve, capital cost overhead and margin component, representing all cost-revenue elements for given product groups, not included under other parameters of the valuation model, e.g.: liquidity margin, administrative costs, residual profit margin required on the market.

7. The zero-coupon rate, being an element of the discount rate, was based on the swap curve appropriate for the currency of the contract.

8. The market cost of capital was determined using the CAPM model and the risk weights assigned to individual asset components.

9. The margin component was determined based on newly granted loans with similar characteristics on the market. The margin was determined numerically for each exposure group, homogeneous in terms of factors identified as affecting the valuation.

IT systems

Fair value of IT systems acquired as part of the Transaction related to the purchase of Euro Bank S.A. shares was determined as follows:

1. Assuming market depreciation rates (5 years for main systems and 3 years for other systems), the net value of systems was calculated. The calculation was based on the assumption that the market rates would be effective from the moment of acquisition of a particular IT system for use.

2. For the 20 systems that are the largest in terms of net values as at the acquisition date, an individual valuation was performed from the perspective of the average market participant.

3. IT systems that were classified as intangible assets under construction as at the acquisition date were measured from the market participant's perspective and their value was determined depending on the decision whether to continue individual projects. For projects that the market participant would have continued in similar circumstances, the capitalized cost was assumed as it accurately reflects the current value and progress of the work. In case of IT systems, which usage will not be continued and additionally due to the specificity of the systems there is no possibility of their sale, the fair value is considered to be null value.

Property, plant and equipment

For all fixed assets containing Euro Bank trademarks and logo the fair value was considered to be null. Fair value of assets classified as leasehold improvements related to adaptation and modernization of space in premises aimed at adapting them to Euro Bank standards (logo etc.) was considered an amortization of 10-month in accordance with market depreciation rates. The remaining fixed assets were measured at the net value, assuming market depreciation rates from the moment these assets are available for use.

Relations with clients in the area of deposits and loans

Relationships with clients holding a CDI (core deposit intangible) have been determined using the favourable source of funds method, as the current value of the difference between the lower cost of financing the acquired savings accounts and the higher alternative cost of financing operations (including interest costs and costs administrative burden) that the Bank would have to incur if it did not have a portfolio of such accounts. For each year of the cash flow forecast, considering the estimated rate of customer outflow, the difference between the alternative financing cost and the cost of the acquired accounts is calculated, and is discounted using an adequate discount rate.

Relations with customers who have credit accounts have been estimated using the Multi-Period Excess Earning Method (MEEM). The value of the relationship is determined based on the current value of discounted future cash flows resulting from additional income generated for the Bank having a given intangible asset, after taking into account the rate of departure customers, costs and encumbrances on capital assets.

The discount rate applied to value customer relationships takes into account the time value of money, the cost of equity and bonuses for specific risks identified in the relationship. The cost of the Bank's equity is determined in accordance with the CAMP model (Capital Asset Pricing Model).

The estimated value of CDI was considered irrelevant, mainly due to the relatively high interest rate on the acquired savings accounts and the possibility of alternative financing of the Bank at a relatively low margin. Due to the above, CDI did not meet the disclosure criterion as a separate asset related to the acquisition. With exception of cash loans there were also no significant relationships with customers having credit products, mainly due to the relatively low level of additional revenues generated by these products, in relation to the corresponding costs of risk, administrative costs and capital charges.

Lease/rental agreements

The conditions included in signed agreements regarding the rental of office space for the needs of branches and headquarters were compared to the conditions of the agreements currently concluded in the market with relation to office areas of a similar area and location. The difference between the rental rate of the acquired branches and headquarters and rental rate of similar areas available on the market was calculated. The amount of the difference was discounted by the discount rate of Millennium Bank, applied for the models of assets measurement under IFRS 16 for the period remaining until the completion of individual contracts. The value of unfavourable agreements adjusted the book value of lease assets' right of use.

Guarantee agreement regarding CHF Mortgage loans portfolio

Fair value of the guarantee determined using income method was estimated as present value of future cash flows expected to be received from Societe Generale S.A. to cover losses related to acquired CHF Mortgage loans portfolio resulting from the future defaults or from the cost of risk of already defaulted loans. In the valuation the value of market spread paid for the similar financial instruments was considered.

Other adjustments

Other adjustments to fair value and the so-called adjustments of net assets resulting from the adjustments to accounting principles concerned, among others, unification of bonds and derivatives measurement, as well as write-off of some other assets items. The determination of the fair value of the assets and liabilities acquired and the identification and recognition of intangible assets resulting from the acquisition were based on the available information and the best estimates as at the date of preparation of the financial statements.

Calculation of goodwill

As at the date of the present report, the Bank did not complete the process of calculating goodwill as at 31 May 2019.

The purchase price allocation performed as at 31 May 2019 shall be considered as provisional and may be subject to changes if the Bank acquires new information as at 31 May 2019, which are not known at the date of preparation of the annual consolidated financial statements for 2019. In accordance with IFRS 3.45, the maximum period for making changes to the purchase price allocation expires after 12 months from the date of the acquisition, i.e. on 31 May 2020. Any changes will be made retrospectively (i.e. they will be recognized in other comprehensive income). The currently determined difference of the fair value of acquired assets and assumed liabilities at the acquisition date over the purchase price is recognized by the Group in accordance with the provisions of IFRS 3.32 as goodwill in intangible assets, which resulted in a significant increase in this item in the consolidated balance sheet.

	Identifiable assets acquired and liabilities assumed measured at fair value	
	thousands zloty	thousands euros
Price transferred in accordance with the Agreement	1,833,000	428,151
Preliminary price adjustment	(16,455)	(3,844)
Price after adjustment	1,816,545	424,307
Fair value of acquired net assets	1,653,788	386,291
Exchange differences	-	263
Goodwill	162,757	38,280

As at the balance sheet date, no impairment allowances for goodwill were recognised in intangible assets.

The difference between the book value of the acquired assets and liabilities of Euro Bank S.A. and their fair value measurement will be subject to settlement through the profit or loss account - in the economic life of the individual components of the assets and liabilities acquired.

Additional disclosures

The Capital Group's profit or loss account, presented as if the acquisition date was the beginning of the reporting period, i.e. on 1 January 2019 is presented below. This data is for reference purposes only, in fact the Group's profit and loss account includes the Euro Bank's result from the date of the merger made on consolidation level (31 May 2019) to Legal Merger performed 1 October 2019.

	2019	
	thousands zloty	thousands euros (*)
Interest and similar income	3,747,541	875,081
Interest expense and similar charges	(1,024,294)	(239,181)
NET INTEREST INCOME	2,723,247	635,900
Dividends from equity instruments	3,240	757
Net fees and commissions income	718,043	167,669
Net gains / (losses) from financial operations at fair value through profit or loss	136,855	31,957
Net gains / (losses) from foreign exchange	165,942	38,749
Net gains / (losses) from hedge accounting operations	(20,008)	(4,672)
Net gains / (losses) from derecognition of financial assets and liabilities at amortised cost	(2,378)	(555)
Net gains / (losses) from derecognition of financial assets at fair value through other comprehensive income	40,952	9,563
Other operating income / (losses)	(422,737)	(98,712)
TOTAL OPERATING INCOME	3,343,156	780,656
Staff costs	938,688	219,191
Other administrative costs	630,687	147,270
Amortisations and depreciations	209,467	48,912
TOTAL OPERATING EXPENSES	1,778,842	415,373
NET OPERATING INCOME BEFORE PROVISIONS AND IMPAIRMENTS	1,564,314	365,283
Impairment for financial assets at amortised cost	(462,561)	(108,012)
Impairment for other assets	(1,163)	(272)
Other provisions	(224,071)	(52,322)
NET OPERATING INCOME	876,519	204,674
Gains / (losses) arising from sales of subsidiaries and other assets	(9,047)	(2,113)
NET INCOME BEFORE INCOME TAXES	867,472	202,561
Income taxes		
Current	(342,921)	(80,075)
Deferred	56,723	13,245
NET INCOME FOR THE YEAR	581,274	135,731

(*) exchange rate PLN /EUR = 4,28250833