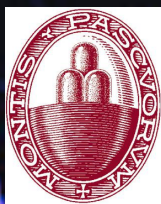


MERGER ARBITRAGE REPORT

The Monte dei Paschi di Siena- Mediobanca case



**MONTE
DEI PASCHI
DI SIENA**
BANCA DAL 1472



MEDIOBANCA



HEDGE FUND DIVISION

Division Head: Andrea De Stefanis
Associates: Shamir Ahmed, Mark Hendrix,
Melisa Eda Yilmaz, Tommaso Galli



General Introduction

This report examines merger arbitrage as an event-driven strategy implemented by hedge funds, outlining its core mechanics, implementation techniques, and associated risks. It then applies this framework to a recent yet disruptive transaction of the Italian banking sector, the MPS-Mediobanca transaction, analysing the structure of the deal, the drivers of the spread, and the execution of a hedged arbitrage strategy. The objective is to evaluate the effectiveness of merger arbitrage in practice and assess its return profile within a real-world context.

Event-Driven Hedge Funds

Event-driven strategies focus on corporate events such as mergers, acquisitions, bankruptcies, and restructurings, seeking to profit from the price adjustments these events create in equity and debt securities.

Event-driven strategies include merger arbitrage (capturing M&A spreads), distressed securities (investing in firms near bankruptcy at discounted prices), activist investing (taking stakes to influence decisions), and special situations (profiting from corporate events that change valuation).

As hedge funds aim to generate absolute returns regardless of market conditions, event-driven strategies are particularly suitable. During economic expansions, a higher volume of deals creates more opportunities for merger arbitrage, while during contractions, increased financial distress among firms generates opportunities for distressed investing.

Merger Arbitrage

When the merger between two companies is announced, the share price of the target company tends to converge towards the offer price. The difference between the market and

offer price is the spread, which reflects the probability of deal success and the expected time of completion. Hence, the spread reflects both completion and timing risk.

Merger arbitrage is the act of purchasing the target company's shares to capture the spread upon closing. The investor increasing its holdings of the target company after the announcement is the arbitrageur. Arbitrageurs engage in merger arbitrage when they believe a deal will complete, thus creating an opportunity to generate returns. This differs from institutional investors, who may reduce their exposure to avoid the risk of the transaction falling through.

The upside of merger arbitrage includes steady returns determined by the spread. However, the downside is characterised by substantial losses in the event of deal failure, most often due to issues like regulatory, financing, or market risks.

In merger arbitrage, hedge funds tend to achieve better returns compared to other investors (e.g. mutual funds) by avoiding worse deals. Deals where hedge funds are involved have a shorter review period and a higher probability of success, reflecting their more in-depth analysis rather than direct influence. The review period refers to the time between deal announcement and its completion or rejection. Furthermore, several articles on hedge funds and their relationship with the investment banks they are the main client of (their 'Prime Broker') suggest that there is a likelihood that investment banks can compensate hedge funds for the fees they bring in by providing them ongoing information on current and upcoming deals in which the bank itself is involved in as advisor. This is one of the cited reasons why hedge funds are able to beat other financial institutions in selecting the most lucrative deals for event driven strategies.



Summarizing, merger arbitrage is an event-driven strategy used during corporate mergers to capture the spread. Its success depends on the ability to assess deal outcomes and accurately estimate completion probabilities through careful evaluation. While it can offer relatively stable returns, it also involves a significant downside risk if deals fail.

Implementation of the Strategy

Implementation of a merger arbitrage strategy is highly dependent on the specific conditions of the merger deal under consideration.

In the case of a cash offer, the hedge fund can simply take a long position in the shares of the target company after the deal is announced. The target company's shares typically trade at a minor discount to the per-share offer, as the market is pricing in the possibility that the deal might fail. The post-announcement trading price is typically higher than the pre-announcement one due to the premium that is usual in a merger deal. Alternatively, the market price misalignment after the deal announcement might also have the company trading above the announced offer price, especially if investors expect an improvement in terms and conditions from the acquirer, or expect a competing bid from another bidder (e.g., a white knight in the case of a hostile takeover bid).

After acquiring the shares of the target company, the hedge fund can wait until the deal is finalised and earn the final offer price for the shares it holds. In that case, the hedge fund's return is simply the difference between the purchase price of the shares and the final offer price. Alternatively, it can sell the shares earlier (on the stock market), before finalisation, especially if it has information that suggests the deal might fail.

In the case of a stock-for-stock deal, the acquisition is paid for with shares in the

acquiring company. Typically, the acquirer offers a specific conversion ratio for the target company's shares (e.g., 2 shares of the acquiring company for each target company share). Since the value of the shares in the acquiring company can move, the hedge fund needs to hedge its long position in the target company by shorting the stock of the acquiring company in the agreed upon conversion ratio (so in this case, if it holds a million shares in the target company, it has to short 2 million shares of the acquiring company's stock), to lock in the value of the acquirer's shares. The hedge fund will only gain from better terms and conditions in this case if the ratio of the acquirer's shares to the target company's shares is increased, or if a cash or alternative value component is added to sweeten the deal.

Deal spreads are often very small (1-8%), so Hedge funds take on significant leverage to increase the payoff (but also the risk) of the strategy. In stock-for-stock deals, leverage is inherent in the strategy, as the cash proceeds from shorting the acquirer's shares are invested in the shares of the target. In cash deals, merger arbitrage hedge funds have to resort to lending to fund their long bets, often using credit facilities from their prime broker, where they lend with their portfolio serving as collateral. Targeted exposure varies greatly by deal depending on the specific characteristics, such as the expected probability of success and the liquidity of the shares of the offeror and target. Leverage usually ranges from 1.5x to 3x the capital allocated to the trade; this is not a hard rule and varies greatly between funds as well as between deals.

Main Risks

- **Deal Completion Risk:** The main risk of the merger arbitrage strategy is the probability that a transaction fails to close. In such



cases, the target company's share price typically declines toward its pre-announcement level, resulting in potentially significant losses for arbitrageurs. For example, when the JetBlue - Spirit Airlines merger failed in 2024 due to a regulatory opposition, Spirit Airlines' share price fell by around 15%. As a result, in merger arbitrage, arbitrageurs earn a small gain when deals succeed but suffer a large loss when deals fail. The deal completion risk arises because there is a time difference between the announcement of a merger agreement and the completion of the planned deal. During this period, several factors can cause a signed deal to break.

- **Regulatory Risk:** Governmental bodies such as antitrust or national security regulators may delay a transaction by imposing further conditions or ultimately block it following a detailed assessment of its market impact and public interest implications.
- **Financing Risk:** The acquirer may fail to secure the necessary funding (debt or equity), particularly if its financial condition deteriorates or market conditions tighten.
- **Litigation and Contractual Risk:** Legal challenges from shareholders, regulators, or other stakeholders may delay or prevent the completion of the transaction. Additionally, changes in market conditions may reduce one party's willingness or ability to proceed, potentially leading to renegotiation or cancellation of the deal.
- **Hedging Risk:** in stock transactions, arbitrageurs hedge by shorting the acquirer's shares based on the exchange ratio. However, this hedge is usually imperfect, leaving residual exposure to market movements and fluctuations in the acquirer's share price.
- **Leverage Risk:** Merger arbitrage strategies frequently utilize leverage to

enhance returns, which also magnifies losses in the event of adverse outcomes, such as deal breaks or spread widening.

- **Timing Risk:** If the deal takes longer than expected (even if it ultimately closes), the internal rate of return drops and the capital efficiency is reduced.
- **Market & Spread Risk:** Changes in market sentiment and implied deal volatility can lead to widening spreads, generating mark-to-market losses for arbitrageurs even when the underlying transaction is projected to complete as expected.

Sources of Spread in Merger Arbitrage

1. Deal Completion Risk & Regulatory Uncertainty

The spread primarily reflects the market-implied probability of deal completion. In expected value terms, the current market price equals: (probability of completion × deal consideration value) + (probability of failure × standalone value) – risk premium. A lower probability of completion or a lower standalone (break) value increases the spread. Regulatory scrutiny (antitrust, cross-border approvals) is the dominant driver of this risk.

Example: NVIDIA x Arm Holdings (2020–2022). Persistent wide spread due to global antitrust opposition; eventual termination confirmed high embedded break risk.

2. Time to Completion & Annualization

Even with high certainty, spreads compensate for the time value of capital. The raw spread is: (offer price – current market price) ÷ current market price. Returns must be evaluated on a time-adjusted basis: annualized return ≈ spread ÷ time to close. Longer expected closing periods require wider spreads to remain competitive.



Example: T-Mobile US x Sprint Corporation (2018–2020). Multiyear regulatory process led to persistently wider spreads driven by duration rather than pure break risk.

3. Market Risk, Hedging Frictions & Financing

In stock-for-stock deals, arbitrageurs hedge by shorting the acquirer, but imperfect hedging (beta mismatch, volatility, dividend risk) introduces residual exposure. In leveraged deals, financing conditions affect spreads through credit availability and cost of debt, directly impacting deal certainty.

Example: Elon Musk / X Corp. x Twitter (2022). Spread volatility closely tracked uncertainty around debt financing and equity commitments during tightening credit conditions.

4. Liquidity, Event Risk & Risk Premium

Beyond measurable risks, spreads include a residual premium for tail risk, liquidity constraints, and arbitrage capital availability. During periods of market stress, spreads widen due to fund deleveraging rather than changes in fundamentals. Event risk (litigation, renegotiation) adds further uncertainty.

Example: LVMH x Tiffany & Co. (2020). Spread widened sharply during litigation and renegotiation uncertainty, reflecting event-driven risk and required premium.

The MPS-Mediobanca Deal

Monte Dei Paschi di Siena (BMPS) is the world's oldest bank still in operation. Based in Italy, its activities are centered around traditional retail and commercial banking services and with a particular focus on households and small and medium enterprises. The Group's key business areas are lending, leasing, factoring, corporate finance and investment banking. As of December 2025, its FY revenues were €4.1bn

with €2.7bn net income and €130 bn total assets, excluding the contribution attributable to the Mediobanca Group.

Mediobanca is an established, specialized Italian financial operator operating in Wealth Management, Corporate & Investment Banking and Consumer Finance. As of June 2025, its FY revenues were €3.7bn with €1.3bn net income and €104 bn total assets.

As of March 2026, Banca Monte dei Paschi di Siena (MPS) approved the merger by incorporation of Mediobanca, creating a new Italian banking champion that blends MPS's retail strength with Mediobanca's wealth management and corporate banking expertise.

Why this deal?

There were several factors at play that raised the expectations of success for MPS's bid on Mediobanca.

Firstly, it was noted that MPS and Mediobanca shared key shareholders that held key ownership stakes in both Banks. The Italian Government had recently reduced its stake in MPS from 60% to 12% over the course of 2024. It held a significant stake because of the 2017 bailout of MPS. After the sell-down, two Italian players held large stakes. Delfin, the Del Vecchio family holding company, had acquired a 10% stake in MPS, whereas Francesco Gaetano Caltagirone, the Roman construction tycoon, held a 5% stake. Simultaneously, Delfin and Caltagirone held a combined stake in Mediobanca of some 30% and were dissatisfied with the board of directors (they had already attempted to oust the CEO, Alberto Nagel, several times). These factors alone significantly increased the likelihood of deal completion.

Furthermore, it was known at the onset that Delfin and Caltagirone held respectively 9.93% and 6.92% of Generali, the Italian insurance



giant, where Caltagirone had been at odds with the board. Mediobanca held a key 13.10% stake in Generali, the largest stake as of 31 December 2024. Together, these three parties were the top three shareholders in the Insurance giant, leading to rumors that the takeover of Mediobanca might have had a double objective: to get control of Mediobanca and replace its CEO, and to work towards control of Generali.

Lastly, the Italian Government expressed its approval of the deal very early on, stating it was in the interest of the Italian economy and the strengthening of the banking system. This support was key, as the Italian Government still held 12% in MPS, meaning it held key voting power to obstruct the offer from the bailed-out lender.

Main Risks

Although large block holders in both entities had strong incentives to make the deal a success, there were regulatory obstacles and concerns over the viability of the combined entity. Firstly, there were allegations that Delfin and Caltagirone were acting in concert to gain “de facto” control of Mediobanca, Generali, and Monte dei Paschi di Siena without explicit regulatory approval from the EU Commission, which they needed as the combined entities far exceeded thresholds requiring EU Commission approval for a merger. As part of its defense, Mediobanca stepped to the ECB to report these allegations. Furthermore, investors had concerns about the implications for the combined entity of being partially under Government control, potentially inhibiting the combined entity from acting in the best interest of the remaining shareholders regarding certain issues.

Regarding the value in the transaction, Mediobanca’s board raised multiple concerns, stating the offer was value destructive for both

banks in its issuer statement to shareholders. Firstly, the board noted that although investors were receiving compensation in MPS shares at a premium to the pre-announcement value of their shares, the payment in MPS shares raised concerns as to whether MPS was fairly valued. Furthermore, Mediobanca’s board noted the lack of industrial logic of synergies between the two banks, as Mediobanca was more focused on advisory services in wealth management and investment banking, resulting in a capital-light model, whereas MPS was largely a commercial bank. The board claimed this combination would have a negative impact on aggregate revenue and income.

Implementation of the Strategy

We treated the announced stock-for-stock merger between Banca Monte dei Paschi di Siena (acquirer) and Mediobanca (target) as a probabilistic convergence trade. The return profile derives from the compression of the spread between Mediobanca’s market price and its implied value under the exchange ratio of 2.3 MPS shares.

We establish a delta-neutral arbitrage position:

- Long Mediobanca equity;
- Short MPS equity at a 2.3 hedge ratio.

The hedge ratio matches the contractual exchange ratio. This neutralizes exposure to broad market movements and isolates the residual spread. Without this hedge, the position would embed directional exposure to Italian financials, which is not the source of return.

Entry strategy: We initiate exposure immediately following deal announcement on January 24th, 2025. At this stage, uncertainty is highest and spreads are widest. Early entry is necessary because spread compression is non-linear and occurs rapidly once key uncertainties



resolve. All the above-mentioned factors increasing the likelihood of success of the deal convert a probabilistic outcome into a structurally supported one. The Italian Government retains influence over MPS; public endorsement of the transaction lowers the probability of domestic obstruction, and so we treat Government alignment as a second-stage confirmation signal.

Our hedge: Because consideration is paid in stock, the implied value of Mediobanca is a function of MPS's share price. This introduces mark-to-market volatility independent of deal probability. The short MPS position is continuously rebalanced to maintain the hedge ratio. Failure to rebalance introduces directional drift, which is when it converts the position into an unintended long or short exposure to MPS. Rebalancing frequency increases with volatility, which then in turn increases transaction costs, but in our case that is secondary to maintaining hedge integrity. If the transaction fails, Mediobanca reverts to its standalone valuation. The premium embedded in the spread is eliminated. MPS is likely to re-rate upward due to relief from dilution and execution risk, so our hedge partially offsets losses. The offset is imperfect due to asymmetric price reactions and basis risk. If we model downside explicitly, our position size is constrained such that expected loss (if the deal collapses) does not exceed a fixed percentage of capital. Mediobanca's board has challenged the fairness of the exchange ratio. If MPS is overvalued, the implied consideration is at a premium. In a stock deal, overvaluation corrects through acquirer price declines. This risk is mitigated by the short trade. A decline in MPS reduces the value of consideration but generates gains on the hedge.

Exit strategy: We exit the position as the spread converges toward zero; convergence accelerates near closing as uncertainty collapses. We do not hold through completion

unless settlement sees no risk; if the position is worth staying in due to our belief that the bank itself is a worthy trade, we would exit immediately. Residual exposure to technical settlement risk is not worth it.

Deal outcome and the return from our investment

On January 24 2025, Monte dei Paschi di Siena (MPS) announced a merger with Mediobanca (MB) through a Voluntary Public Exchange Offer (stock-for-stock deal), with an initial exchange ratio of 2.3x (2.300 MPS shares per MB share). Prior to the announcement, MPS and MB's stock prices were respectively €6.95 and €15.23 (as for closing). Hence, at the time, the offer implied a premium of approximately 5.03% relative to Mediobanca's share price.

We initiated the position on this date by going long Mediobanca at €16.00 and short MPS at €6.75, initially hedged at an exchange ratio of 2.3, and subsequently adjusted to 2.533 following the dividend announcement on 20 May.

The initial offer required a 66.7% acceptance threshold to acquire control and full ownership, alongside a minimum of 35% for the deal to continue. During the provisional offer period, which ran from the 14th of July to the 8th of September and gave shareholders the first opportunity to respond, concerns emerged about failing to reach the acceptance threshold and dissatisfaction with the original terms. As a result, on the 2nd of September 2025, the exchange ratio was adjusted to include a cash component of €0.90 per share.

The provisional results were published on the 11th of September, with 62.3% of the share capital of Mediobanca accepting and with the consideration paid on the 15th of



September. As of this date, MPS's share price was €8.41 while MB's stood at €22.01.

Assuming deal completion, we exit our position following these results. As we entered at €16.00, we were able to capture a spread of approximately €6.01 per share, with a return of 37.6% on the long position as the price converged to the implied offer value. This was combined with a short position in MPS, which generated a loss of 24.6% per share as its price increased, partially offsetting the gains from the long position. Hence, the strategy generated an overall return of 11.3%.

Investors then had a second acceptance period from the 16th to the 22nd of September. On the 25th of September, following this reopening period, MPS reached 86.3% of Mediobanca's share capital with payments due on the 29th of September. This percentage was not enough for the delisting, hence Mediobanca has continued to trade on the Euronext Milan (as of April 2026).

Conclusion

The merger arbitrage strategy implemented in the MPS-Mediobanca transaction generated a total return of 11.3% over an eight-month period, equivalent to an annualized return of approximately 17.4%. However, this return should be interpreted with caution, as it does not account for the impact of leverage or transaction costs, both of which would materially affect the net performance, especially in such strategies.

This performance was driven by the successful convergence of the spread, supported by strong shareholder alignment and Government backing, which reduced deal uncertainty over time. The presence of large overlapping shareholders and political support significantly reduced deal uncertainty over time, allowing

for progressive position scaling and effective risk management.

Importantly, the return must be evaluated in the context of the asymmetric risk profile inherent in merger arbitrage. While the strategy offers relatively stable and uncorrelated returns when deals complete successfully, it remains exposed to significant downside risk in the event of deal failure. In this case, the use of a delta-neutral hedge and disciplined position sizing helped mitigate market and idiosyncratic risks, ensuring that potential losses remained within acceptable limits.

Overall, the trade can be considered successful not only in absolute return terms, but also on a risk-adjusted basis. It highlights how merger arbitrage, when supported by rigorous analysis of deal fundamentals, stakeholder incentives, and regulatory dynamics, can generate consistent returns independent of broader market direction. However, the strategy's effectiveness ultimately depends on accurate probability assessment and strict risk control, as misjudging deal outcomes can quickly offset multiple successful trades.



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