STRATEGIC M&A

by Steve Brown

Flip flops, anarchistic t-shirts and outfits that would be more at home at the Moulin Rouge is the lore of many a bank's Casual Friday. Dress code violations on casual work dress days are usually a result of management being unclear or having no formal notice as to what is "acceptable." In similar fashion, mergers for banks can suffer from the same problem. They are often ill-fitting, usually because management has failed to lay out a clear strategic plan. Taking any merger that comes your way because it is the right price may also result in your bank not looking its best.

The downturn in banking has served to decrease purchase prices and created purchasing opportunities for strongly capitalized banks. One of the most overlooked, though seemingly obvious, elements of an effective M&A program is ensuring that your bank is not doing a deal just because it there is a deal to be done. In other words, a deal must support an articulated corporate strategy.

Common goals might be to gain market share, lower overhead costs, expand fee income or lower funding costs. Whatever the bank is trying to accomplish, a set of clear strategic goals encourages you to be truly proactive in sourcing deals. It also helps establish a framework for determining priorities, valuation ranges and drives M&A efficiencies. Most banks only set M&A parameters based on size and geography. The reality is many successful mergers are driven by other factors such as culture, product mix and customer positioning. If a bank only has size as a driver, the acquiring bank may be passing up better uses for its capital and resources.

This isn't to say that growing market share isn't important; our point is only that other factors may be more important. This being the case, it pays to fully flush out an acquisition strategy as to best utilize precious M&A due diligence resources. For example, evaluating a potential acquisition to expand a cash management product line up, may take different due diligence resources that a deal that is being driven to increase loan growth. A focused M&A effort starts with a focused strategy and usually results in a focused and successful acquisition. The profile of a potential acquisition candidate also helps set valuation. On average, valuation ranges should be higher for banks that are being acquired because of their liability structure, than a bank that is simply being acquired to in-fill geographically.

Successful corporate governance starts by setting (or affirming) the bank's strategic goals each year. Then, the M&A team can take those goals and can turn them into a set of parameters that management and investment bankers can use to filter potential acquisitions. Each potential transaction should be compared to the stated goals of the bank to ensure management is on the right course. A goal of "reducing funding costs and interest rate sensitivity by 15%," may be best achieved by organic means or it may come through an acquisition. Using strategic objectives as a measuring device will prevent a bank with already stressed funding from ending up with a bank that has high loan growth.

Determining in advance what types of deals your bank intends to pursue and then knowing how to manage them through the acquisition process will result in a more successful structure. The goal of a merger should be to make sure that earnings from mergers equal more than the sum of its parts (and that your next merger doesn't end of up fitting like a bad tank top).

BANK NEWS

M&A

Wells Fargo ($595B, CA) will acquire Century Bancshares Inc. ($1.4B, TX) in an undisclosed stock swap. Wells will capture 32 branches and extend its presence into AR (Century has 4 braches in Arkansas and 28 in Texas).

Economic Weakness

Chief Investment Strategist for Merrill Lynch said yesterday that credit conditions have "deteriorated significantly from July," that investors were "significantly underestimating" the extent of the crisis and that the crisis was "far from over." The comments indicate the credit crunch will continue.

Nasty Housing

RealtyTrac is reporting that the number of homes that received at least one foreclosure notice in July climbed 8% from June and was up 55% from the same period last year, as housing conditions worsened. Meanwhile, bank repossessions jumped 184% YOY, default notices soared 53% and auction notices climbed 11%.

Housing Timeline

Former FOMC Chair, Alan Greenspan said in an interview yesterday that he expects "home prices in the U.S. are likely to start to stabilize or touch bottom sometime in the first half of 2009." Let's all hope he is right.

Strong Dollar

The Euro fell to a 5 Ã,Â½ month low against the dollar, after reports showed Europe's economy contracted for the 1st time since the Euro currency was introduced 10Ys ago.

Ugly Equities

The daily price to book for the S&P 500 Index fell to its lowest since data collection began. From February 2007 to July 15 the index has dropped over 50%, the steepest decline in over 45Y.

CRE Exposure

The OCC indicates the average community bank carries CRE loans equal to about 285% of capital, about double levels from 2002.