SITTING AROUND MOVING PIECES OF THE M&A PUZZLE

by Steve Brown

You may not have been keeping close track of the moving pieces, but over the past 2Ys, large companies have been moving more employees into so-called "unassigned" workspaces. This shift toward not having a permanent assigned physical desk for each person saves money, improves creativity, boosts productivity and allows staff to change their environment through the convenience and flexibility offered by laptops and tablet computers. To see how prevalent this has become, consider a study by the International Facility Management Association that found 60% of nearly 1,000 large companies surveyed now have unassigned work spaces in their offices. If you are considering this or just pondering how to save money and consolidate, consider moving more people into open environment shared spaces. Think about who is in the office full time and who is not, as you consider unassigned workspaces for sales people, customer facing teams, auditors and others who have jobs that provide the flexibility to work at unassigned desks.

We bring this up because some banks are pursuing M&A strategies and this approach to office space post-merger might come in handy. On the M&A front, suffice it to say that weak loan demand and limited opportunities to generate non-interest income have increased interest in strong banks looking at deals. While the interest is certainly there, problems usually increase as acquirer and acquiree try to agree on a price, deal with the human elements of board interaction and work through the complexities of purchase accounting. The problem with purchase accounting in particular, is that it requires the acquiring bank to mark all assets to fair market value and then apply the difference between that number and the final price paid as goodwill. The goodwill number is then subtracted from future earnings of the new entity over time, which results in a longer ramp to gain a return for the deal. That issue, combined with the problems of valuing a loan portfolio in the first place (for example, some loan types could be priced at 40 cents, while others may be priced at perhaps 90 cents on the dollar), can increase the stress of any potential transaction, well before the politics of combining previous competitors ever kicks in. That doesn't mean bankers aren't interested in trying some sort of acquisition out, however. In fact, a 1Q survey by Crowe Horwath finds that while about half of banks don't plan to make an acquisition of any sort this year, about 37% want to buy a healthy bank, 27% want to purchase branches and 23% are seeking an FDIC assisted transaction. In short, the pieces of the puzzle are moving around and some are beginning to fit, but it must be the right deal at the right price with the right partner, so game playing remains slow right now. On the pricing front, consider analysis from SNL Financial, who reviewed the 31 banks that had disclosed a sales price so far this year. While some were willing to pay high multiples (highest was Cadence Bancorp's purchase of Encore Bancshares for 2.4x tangible), the median price was 1.16x tangible (up from 1.08x the prior year). In all, about 43 deals have been done this year for a total of $4.4B, about the same level as in 2011. For 2011 as a whole, SNL reported bank M&A hit 176 deals worth $17.0B (vs. 215 deals for $12.2B in 2010). For sure, no one yet knows how this year will end up, but we believe it will be slower than expected due to a variety of factors. In fact, this is echoed in the results of the same Crowe Horwath survey. It found that 66% of bankers who might seek out an acquisition were worried about the asset quality of a potential target, 57% saw unrealistic pricing expectations and 44% just weren't interested because of the risk in doing anything given such an uncertain environment. No matter what your bank's position is on pursing an acquisition or selling; you may want to consider the immediate lift you can get by putting together the seating chart puzzle in new and different ways to boost flexibility.

Related Links:
PCBB 2012 Executive Management Conference

BANK NEWS

JP Morgan

Jamie Dimon was on Meet The Press on Sunday and failed to answer the basic question we keep asking - if the trade in question was long TIPs for inflation protection and long a basket of corporate credit default swaps, isn't that the same risk that is in JP Morgan's loan portfolio? How is that a "hedge"? In related news, JP Morgan is said to be accepting the resignations of 3 employees responsible for the trade, including the chief investment officer.

Ally

After getting hit with a deluge of lawsuits from consumers and investors, Residential Capital, a mortgage sub of Ally Financial, will file for Chapter 11 bankruptcy. In related news, Ally also said they will sell their international business to include auto finance and insurance.

Internal Strife

Basswood Capital Management, a 5.2% owner in First California ($2B, CA), is pushing the board to "better consider" PacWest Bancorp's ($5.2B, CA) 32% premium, 1.67x tangible book under threat of removal. While PacWest alleges First CA refused to negotiate, the Board of First CA is said to be lukewarm on the offer and has now officially asked for more time to consider it.

Regulation

The CFPB is considering new rules that would simplify the way mortgage points and fees are handled. Some proposals under consideration that could be in place by this summer include requiring an interest-rate reduction when consumers pay discount points; banning origination fees tied to a loan's size; mandating lenders offer consumers a no- discount-point loan option and establishing qualification and screening standards for mortgage loan originators.