MAKING BANK M&A FROM iPADS & CARDBOARD BIKES

by Steve Brown

The iPad has changed the world for the better many would argue. While perhaps ultimately not as big an impact as the iPad (or maybe eventually bigger), an Israeli inventor and amateur cycling enthusiast has come up with a bicycle manufactured almost entirely out of cardboard. If it works as billed, cardboard bicycles could be mass produced for $9 (and sold for $20), they would be light but also quite sturdy, they would use solid tires that never get a puncture (last for 10Ys) and they would use a car timing belt instead of a chain. Cardboard bicycles could literally transform transportation, particularly in poorer regions of the world, so they would be pretty nifty if everything works as the inventor suggests. Patents have been filed and are pending, but expect to read more about these bikes in the next few years as production gets underway. Both the iPad and now perhaps even the cardboard bike will go down in history as truly disruptive technologies.

On the subject of disruption, one doesn't have to look very hard to find it in the banking industry. One area where there is a lot of hype and recent activity is in the M&A arena. That is why we were intrigued by a recent survey from the ABA and Crowe Horwath on the subject. In particular, the survey asked bank executives what they saw as barriers to M&A.

Among the findings: 56% said it was due to a lack of attractive deals; 33% indicated it was due to a lack of capital, sources of capital or regulatory complications (not capital related necessarily, however); 31% mentioned uncertainty in the market; 26% identified internal capacity constraints; 21% focused on purchase accounting rules and negative capital impacts; and 11% said other (not too sure what that means).

Clearly, there are all sorts of reasons why bankers may be unwilling to do a specific M&A deal, but the market and regulations have added significant complexity to the process. Consider that you want to buy the bank down the street and they are interested in selling. You both agree on 1.2x book, which is pretty good in this environment. The problem is, how do you do the math given all the unknown risk of the loan portfolio (although largely improving, there is still residual risk), the true "value" of the capital structure and the oddities served up by a still-in-flux Basel III (will it hit community banks or not). Even the savviest banker with a top-notch investment banking team will have difficulty valuing everything given the math is still in flux.

Perhaps that is one reason why some bankers are looking instead at banks teetering on the edge. Sure they have loan problems, but some have decent franchises as well. Taken down just before an FDIC forced closure can be one way to go, but it takes nerves of steel and a lot of extra capital capacity. Some banks have that, which is why you hear rumblings of due diligence teams looking at these entities more now (rather than just doing advance due diligence and waiting for a failure to occur). Not for every buyer obviously, but interesting.

Another route is to go to the best performing bank in the market and let them know you want them to join your team. It will cost more to buy them, but in the grand scheme of things, prices remain historically inexpensive. As such, even a cash purchase can have value - even if it is at a higher multiple. This approach also takes guts, but at least history is on your side and the opportunity could be a good one over the longer-term. To do this you must have patient shareholders, but buying a known quantity that has operated strongly through the credit crisis could make sense despite a higher cost to acquire.

As with the cardboard bicycle, it may be awhile in community bank M&A before we really know if this is going to work out as planned, but at least the wheels are turning.

BANK NEWS

Branching

Rather than buy a bank in the state and truly bucking the trend of branch closures, BB&T said it has chosen to open 30 branches in Texas.

Employee Search

Studies find 75% of human resource departments do a Google search on every new jobs applicant.

Parent Support

A study by the National Center for Policy Analysis finds 59% of parents with a child between 18 and 39Ys old are providing monetary support. Of this group, 48% were helping kids with living expenses, 41% with transportation costs, 29% gave them spending money, 28% paid medical bills and 16% were helping to pay back loans.

Audit Change

Effective Jan. 1, 2013, internal auditors will follow revised Institute of Internal AuditorsÃ¢Â€Â™ standards designed to better align auditors with the board, support timely adjustments to the audit plan to ensure strategic objectives are achieved and to make sure unacceptable risks are reported directly to the audit committee.

Ugly Situation

Spain reports its unemployment rate has now reached 25%.

Partial Repayment

Ally Financial has repaid $2.9B owed under TLGP and said it will repay the remaining $4.5B in Dec. of this year. That is good because the Treasury still owns 74% of Ally.