BANK M&A - WHY GOOD NUMBERS COUNT

by Steve Brown

To understand why numbers are like child's play to banks and why they are important, consider a brief digression. You might find interesting how the iconic Heinz "57 Varieties" slogan came to be. It seems founder Henry Heinz was inspired by a billboard he saw in New York in 1896 that advertised "21 Styles of Shoes." The use of numbers appealed to him and even though there were more than 60 varieties of his ketchup at the time, he chose the number 57. Banks love numbers, especially as they relate to financial reporting and deal-making. Indeed, new academic research by Professor Hollis Skaife from the University of Wisconsin-Madison and Daniel Wangerin of Michigan State University suggests that companies might have more difficulty closing merger deals if shoddy financial reporting and internal controls are in play. That sounds perfectly logical, but it is critical information if your bank is a potential acquirer. Consider as well that nearly 50% of banks surveyed recently by KPMG purport to be. It's important to pay attention to these details whether a buying or a selling bank. Of course, mergers fall apart for many reasons and failures aren't limited to the banking world. According to recent data from Standard & Poor's, some 639 US-based deals (bank and nonbank) were terminated last year. How many of those deals would have gone through had company executives paid more attention to the quality of their financial reporting? While rhetorical, it's a particularly timely question to ask, given the spike in M&A that is expected to occur in the banking industry over the next few years. Some analysts expect between 200 and 400 mergers and acquisitions in the banking industry this year, the vast majority of which will be community banks. That level compares with only 121 in 2008. The key to a good merger situation is to make sure your bank has quality financial reporting in place. Studies show that M&A can be a powerful tool for growth as it introduces the acquiring bank to new markets, products, customers and capabilities. But it is important to note that these and other benefits can quickly dissipate when deals sour and fall apart due to inadequate financial reporting. Key lessons for banks from Deloitte are spelled out in a recent report of theirs. It found CFOs of target banks should strive to improve the quality of their financial reporting so a deal can proceed smoothly. For the acquiring bank, it makes sense to take a hard look at the target's books, searching with a fine-tooth comb for any issues that could potentially derail a deal. It's important to ask, for example, whether auditors have noted any significant or material weaknesses in the target's financial reporting or internal controls. Another thing to find out, according to Deloitte, is what adjustments and reclassifications were proposed during prior audits and whether they were corrected. Deloitte also points out how important it is to be aware of accounting errors that required restatements and whether the target has had material out-of-period earnings or expenses in the past year. Whether you are a buyer or a seller, quality financial reporting is a must to a successful merger transaction and it doesn't have to rise to the level of fraud to cause problems. Aside from the greater risk of failed deals, shareholders and employees will be disappointed and bad publicity certainly won't help bring in new business. Doing a deal correctly using quality data and reports could be the difference between closing a quality transaction vs. being associated with a deal that didn't work out.

Related Links:
PCBB 2013 Executive Management Conference

M&A

1st United Bancorp ($1.6B, FL) will buy Enterprise Bank of Florida ($233mm, FL) for about $6mm in cash, $24mm in nonperforming loans and $15mm in other impaired assets. Puget Sound Bank ($268mm, WA) will buy Core Business Bank ($64mm, WA) for $8.4mm in cash and stock. CorTrust Bank ($680mm, SD) will buy Blaine State Bank ($36mm, MN) for an undisclosed sum.

BANK NEWS

Bank Business

A study by KPMG finds 90% of banks are currently reevaluating their business model, including products and services offered, structure, etc.

Real Regulation

The US has warned companies that provide virtual currencies (such as Bitcoin) they are subject to money laundering rules, amid increasing concern such vehicles could be used for illicit purposes.

Taxes

Taxes are due just around the corner so you might be interested to know 75% of people last year got a refund from the IRS (avg. amount of $2,803) and 80% of people e-filed.

Credit Rating

The FTC finds 2.2% of credit reports have mistakes in them big enough to raise the cost of borrowing for the consumer.

Expensive Pennies

The US Mint last year paid about 2 cents to produce and ship each penny it created last year. Perhaps it is time to discontinue making the coin.

FOMC

The Committee modestly lowered its growth forecast for the next 3Ys (mostly driven by sequestration), but increased its expectations for the jobs market. At this point, the majority of FOMC members expect the first rate hike to occur in 2015.

Bank Dividends

In 2012 Wells Fargo paid out 43% of profits to shareholders while JPMorgan paid out 28%. Both are expected to pay out about 70% to 80% this year.

Oil Dominance

For the first time in history, China surpassed America as the world's biggest oil importer at the end of 2012. America's dependence on foreign oil has declined recently, driven by higher shale oil extraction.