M&A; Mania Or Hype

by Steve Brown

There are long-term culture-changing trends like the smart phone, and then there are short-lived fads. Think about leg warmers for aerobics class, or even aerobics class itself (fast forward to Zumba). Did you ever buy Pet Rocks or Chia Pets for your entire holiday shopping list?

You've seen the numerous M&A listings in the right column of this publication and some days it may seem like everyone is jumping on the M&A bandwagon. The question is whether everyone is thinking this action through strategically, or whether this is more of a fad that will fade as loan demand heats up and profitability jumps for banks of all sizes (already happening). Bankers have heard all the statistics and dire predictions that smaller banks just aren't going to make it. The argument is that costs are too high and every bank under (pick a number) in asset size will have to merge or perish. We don't agree and find that this sort of overgeneralization is often promoted by those who may stand to benefit the most, and are likely in the business of selling M&A services. Certainly bank size is one measure, but all markets are different, overhead costs vary dramatically, competition is vastly different and many banks simply do a great job no matter their asset size. Looking at the research, we would be remiss if we didn't point out that the success rate for mergers has not been that great - whether looking at banking or other industries. Think of the culture clash between Daimler-Benz and Chrysler, or remember when Quaker bought Snapple for $1.7B and then sold it 27 months later for $300mm.

Look also at the time period between 2000 and 2008 when Wells Fargo acquired 19 banks. This was all about gaining market share and geographic coverage and probably little time was spent worrying too much about cultural fit of these acquisitions. In more recent M&A activity, the data shows the average buying bank has been around $1.5B in assets and the average seller around $300mm. For banks of this size, one could argue cultural fit matters a great deal.

Certainly some banks may eventually merge, and for some it can make sense, but we would say any bank considering a merger should delve deeply into how the merger will build franchise value. There are many elements beyond the purely financial that are critically important, and these cultural and strategic elements shouldn't be left to the corporate finance consultants. They are best assessed by the people who truly know the bank - namely, the people within the bank. Merging banks also don't have to be the same, indeed differences between merging parties can complement one another and diversify the business model.

When assessing a potential strategic fit, banks must ask and answer a lot of questions. First, assess each market as measured by its population density. Also assess population and economic growth dynamics. Are the economic engines of the merging banks similar or complementary? Also consider the product mix. For instance, if one bank has primarily agriculture lenders and the other bank focuses on commercial real estate, there could be great synergies or a potential clash of cultures. Is this an opportunity for a bank to diversify its income stream, or will it lead to problems? Do the merging banks have similar competitive forces and market share in their respective markets? Do the management teams have a similar outlook and are business customs compatible?

If the merger appears to be a good fit after careful consideration of all things financial and cultural, the next hurdle is one of integration. Obviously the customer experience is of paramount priority but so is the handling of important employees and producers in the bank. Management should be decisive about the direction of the new organization and make every effort to integrate the most successful elements from the existing banks into the new organization. The new bank will then grow out of the best of the new and old and should have a good chance for success. For those banks that are doing fine just as they are, our advice is to keep up the good work and stick to a simple business model that feeds off of an expanding economy. We are hearing about more loan opportunities all over the country. Stay focused because more fun is on the way, if it hasn't already reached your bank and your market.

BANK NEWS

M&A

Southern Bancorp Bank ($1.1B, AR) will acquire The Bank of Bolivar County ($17mm, MS) for an undisclosed sum.

Branch Consolidation

New Peoples Bank, Inc. ($696mm, VA) said it will consolidate 4 branches in VA and WVA as it seeks to reduce operating costs.

Optimistic

A survey by Deloitte finds 45% of CFOs at major North American companies expressed rising optimism, marking the 6th consecutive quarter where more expressed optimism than pessimism. CFOs cited rising growth expectations, higher projected YOY earnings, more capital spending, increased sales growth expectations and more domestic hiring as factors.

Priorities

The same Deloitte survey of North American company CFOs also finds the top priorities for CEOs right now are cost reduction (58%), monitoring progress against targets (47%) and revenue growth (43%).

P2P Growth

The Fed reports peer to peer (P2P) lending that matches borrowers with investors online has grown an average of 84% quarterly since 2007 vs.2% for bank consumer finance lending and 0.7% for bank credit card lending.