Merging In The Face Of A Crisis

strategic planning Mergers and Acquisitions pandemic

Summary: The economic downturn has been tough for financial institutions, but mergers are occurring during the pandemic. We explore a few recent mergers that provided new opportunities for both parties.

The founder of Wendy's, Dave Thomas, didn't graduate from high school. But, he got his GED in 1993 and his GED class voted him "Most Likely to Succeed." This goes to show that even when the future may not look bright, things can change all of that. Similarly, some bankers right now may be looking at mergers as "the things" that could change the outlook for their financial institution.

The economic downturn has been tough for many community financial institutions (CFIs). For some, a lifeline may be to merge with a stronger bank. A merger could not only help resolve the financial squeeze on troubled banks, but also gives more robust CFIs an opportunity to expand or deepen their footprint in existing territories and create synergies.

Case in point: a community bank in NY, recently agreed to a "merger of equals" with a peer bank in NY. The pandemic and the resulting economic slump hit the community bank's loan portfolio hard. Its apartment building loans had become a particular sore spot, as tenants who were furloughed or laid off due to the pandemic stopped paying rent. When building owners can't collect rent, they have trouble staying current on their loans, which can quickly undermine a bank's bottom line.

The solution was to find a merger partner, and they found one that wanted expansion into other areas of NY, especially Brooklyn. Furthermore, the merger would reduce overall portfolio exposure to the troublesome apartment loans. Before the merger, the community bank had 60% of its loan portfolio tied up in apartment loans; after the merger, the ratio would drop to 44%. Other merger perks included savings by consolidating back-office functions and eliminating duplicate positions.

To some analysts, the timing of this merger is far from ideal. The financial fallout from the pandemic remains a moving target, and there is no guarantee that a merger won't simply create a bigger institution with even bigger problems. But waiting may not be an option either.

Other community banks have taken a similar view toward mergers as both a solution to certain problems and an opportunity for growth. For example, a community bank in NC recently merged with a peer bank in FL to give it the desired expansion into that state.

In another instance, a community bank in TN combined with a fellow TN bank to join the billion-dollar club (from assets of $948MM) and as a way to extend its lending capacity.

At the start of 2020, analysts were predicting a strong year for M&A activity among community banks. Then the pandemic hit and put a damper on everything. But as recent deals are showing, some of the economic fallout from the pandemic may also provide a stimulus to M&A activity, as stronger banks weigh the benefits of merger opportunities with banks needing a lifeline.

As for timing, partners are carefully weighing the current uncertainties versus the potential benefits. If you are contemplating this, you will want to do the same. If instead you are looking for a strong merging partner to provide some assistance, look for synergies and complementary goals to reap the best rewards.

<B>WEBINAR:</B> STRESS TESTING WITH COVID-19

Economic uncertainty is raising the same two questions across many institutions: **What loans are at risk? Do you have enough capital?** Join us on Wednesday, July 29th at 9 a.m. PT, as we review two approaches to address these questions.