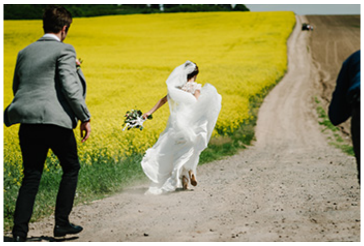

Contemplating M&A in 2023? Here's What — and What Not — To Do

industry update Mergers and Acquisitions

Summary: After a dearth of M&A deals within the financial services sector last year, what will 2023 activity look like? We provide six tips on how institutions can both successfully strike a deal and then see it through.

Julia Roberts' character in the 1999 "Runaway Bride" flick had the hardest time exchanging vows with any fellow. She would even get all the way up to the altar at times, and then the deals would always fall through. Once she figured out why she was sabotaging any union, the merger with Richard Gere came to fruition.

The M&A landscape for community financial institutions (CFIs) over the past year can sometimes feel like "Runaway Bride," and many deals weren't even struck at all because too many CFIs stayed out of the market. But will that change this year?

Across the industry, the number of financial institution deals last year fell to 167, down from 205 in 2021, according to S&P Global Market Intelligence. Experts cite increased scrutiny from regulators, higher interest rates, and economic uncertainty as the likely reasons why. These factors are still in play this year, but the need to scale up with an M&A deal for greater efficiency may spur more CFIs to take the plunge anyway.

So, too, might institutions with the need for more funding. Acquirers value deposits more now than they did a year ago. In order to pass the regulatory approval process, institutions are pushing through smaller transactions to *"grow their asset base and retain deposits or add to liquidity,"* according to a Piper Sandler head of investment banking. Other CFIs believe that they can more effectively advance their digital transformation strategies through an M&A deal.

Still, many experts believe that the current economic uncertainty — as well as a continued rise in interest rates driving up tangible book value dilution — will weigh heavily on CFI M&A activity. One industry attorney notes that M&A deals will continue to be scarce until financial institutions are more confident in what the future holds. *"Uncertainty is really kind of like a wet rag on the whole M&A scene in banking right now."*

There's also the risk of higher credit quality issues in any downturn, which furthers hesitation to take on additional risk. This may continue through 2023 as we grapple with a potential recession that could affect that credit quality. Experts are confident, however, that once the uncertainty surrounding interest rates and the economy clears, M&A deals will increase.

Here are **six tips to increase the chances that an M&A deal not only will be struck, but also completed:**

1. **Have enough capital.** Make sure you have adequate capital to handle the integration of an M&A deal, as most transactions typically reduce combined capital ratios as a result of purchase accounting.
2. **Confer with regulators first.** Test the waters with regulators before moving forward with a merger. Being proactive and involving them before filing will help CFIs deduce how the merger might be received and help avoid any potential tie-ups.

3. **If possible, make it an all-stock deal.** Since all bank valuations are down, if a CFI has a strong share price, its board should consider paying for deals with stock. This will make a proposed merger more appealing for targets seeking liquidity, edging out the competition.
4. **Don’t let the desire to buy override proper valuation.** Many CEOs are so eager for an M&A deal that their financial teams then bend the numbers to make them work, and as a result, they overpay, says a second M&A consultant. Then during the integration of the target institution, the acquirer has to aggressively cut costs, hurting “the revenue machines” that they bought.
5. **Have a tried-and-true due diligence process.** A CFI based in Montana has a dedicated M&A evaluation process based on a strict set of financial metrics, its CEO says. They evaluate carefully and don’t waste time if an institution truly isn’t a good fit for them. *“We buy a bank primarily based on how it’s performing today. We don’t believe we should pay for what we can bring to the table in the future.”*
6. **Be prepared for public hearings.** They’re becoming more common as regulators increase their scrutiny of M&A deals. If you’re entering an M&A deal, make sure you are prepared to demonstrate the value of the proposed deal to all stakeholders at such hearings. Prepare teams to devise proposals that show you have taken the necessary steps for this potential merger, and that it will benefit all of the communities affected by it.

Although current economic conditions make mergers less attractive at the moment, their value remains the same, particularly for those seeking more funding or needing to scale for more capabilities. If your institution’s board is contemplating an M&A deal this year, make sure you do proper due diligence, confer with regulators, and prepare to demonstrate the likely value of the arrangement to all affected stakeholders. By doing so, the chances for success drastically increase.

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ECONOMY & RATES

Rates As Of: 03/29/2023 05:46AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	4.80	-0.08	0.38
6M	4.90	-0.27	0.14
1Y	4.53	-0.48	-0.18
2Y	4.09	-0.73	-0.34
5Y	3.68	-0.51	-0.32
10Y	3.59	-0.34	-0.29
30Y	3.80	-0.12	-0.17

FF Market	FF Disc	IORB
4.83	5.00	4.90
SOFR	**Prime**	**OBFR**
4.84	8.00	4.82