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Conference Chatter

Bank, Thrift & Broker/Dealer - Operations and Strategy

Bank M&A revival might take act of God

BLOG

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Traditional M&A activity is not likely to pick up anytime soon, but a few institutions could use creative structures to act opportunistically and take advantage of what some bankers believe is a once-in-a-lifetime opportunity.

The M&A market is slow, if not dead, with aggregate deal values in 2009 totaling about \$1 billion, or just a fraction of deal activity in recent years, as many participants at the [SNL Bank M&A Symposium](#) noted. Transactions are still being done, but nearly half the deals have been government-assisted transactions, demonstrating that few buyers want to take on asset risk.

"If you want to choose one word for the state of the M&A market unfortunately, I think the word is dismal," Sullivan & Cromwell LLP Chairman Rodgin Cohen said during the opening remarks of the event.

There are plenty of barriers to getting deals done in the current environment. One notable roadblock is buyers' lack of confidence in sellers' valuations of their balance sheets. Another is purchase accounting rules, specifically 141R, requiring acquirers mark a sellers' balance sheet to market, usually resulting in a major capital hit to the buyer. The common theme among comments at the M&A Symposium was that such uncertainty, combined with financially unattractive accounting rules, have put whole bank deals on hold for the vast majority of institutions. Even healthy banks seem focused on government-assisted transactions, which offer buyers minimal asset risk and the possibility to book a [sizable](#) gain in the first quarter after closing when a loss-share agreement is in place. In those cases, the buyer records the full value of the FDIC's loss-share agreement as a receivable right after close.

"The driving force in today's market really [is] the FDIC opportunities," Rick Maples, co-head of investment banking at [Stifel Nicolaus & Co. Inc.](#), said at the conference.

It does seem that many, many healthy banks are waiting for bank failures in their market so they can enter into a deal with the government. Daniel Bass, managing director at Carson Medlin, questioned that philosophy, since there usually is little franchise value left after a bank fails. Failed banks have high-cost deposit bases, and their employees are the ones that made bad enough loans to take down the bank, he said. But government-assisted deals do make sense as a de novo play, Bass said, if the buyer simply wants the failed bank's branch network.

[IBERIABANK Corp.](#) bought into that approach with its first government-assisted deal of the cycle – the purchase of [ANB Financial NA](#) from the FDIC – by taking on the failed institution's branch network and only a few deposits and virtually no loans. John Davis, senior vice president of M&A and finance at IBERIABANK, said at the event that government-assisted deals are more favorable due to the attractive economics and short approval and assimilation process associated with the deals, which keeps the buyers from worrying about the target's employees being poached. He said the company looked at purchasing healthy companies, but does not think those deals will work until sellers realize just how bad things really are.

That could take awhile. Philip Sherringham, president and CEO of [People's United Financial Inc.](#), one of the most able acquirers in the banking industry, said sellers' price expectations still do not make sense. He plans on making an acquisition and possibly a large one, but noted that he is not in the acquisition game for it to be an endgame.

[KeyCorp](#) Chairman and CEO Henry Meyer III added that there is so much uncertainty in the marketplace right now and that his company is really in a wait-and-see mode when it comes to acquisitions.

John Kanas, the veteran banker who led an investor consortium to [acquire BankUnited Financial Corp.](#) as part of a rollup strategy, said he is waiting for the U.S. consumer to turn around before putting significant money to work. The last cycle had many challenges, but he said that in the current downturn the consumer, banks' core customer, is under tremendous stress. He needs to see a turn in the consumer as well as some stabilization in real estate prices before making an acquisition.

To get deals done in such a tough environment, Carson Medlin's Bass said investment bankers need to be creative with their structures. For instance, Bass highlighted a recent transaction he worked on, where the target's classified assets were included in the transaction's purchase price. In that deal, the seller held onto the classified assets, which it believed were worth more than market values, and the buyer took on the seller's TARP funds and clean assets.

Investment bankers at the event pointed to other creative transactions such as [First Niagara Financial Group Inc.'s purchase](#) of 57 National City branches from [PNC Financial Services Group Inc.](#), and its pending [acquisition of Harleysville National Corp.](#) The National City deal was structured such that PNC provided a \$150 million "seller" financing line of credit, offering First Niagara the opportunity to access funds without having to tap the capital markets. And the Harleysville deal included a price adjustment mechanism based on increases in delinquent assets, and a material adverse change provision tied to specific performance measures that would allow First Niagara to walk away from the deal.

Both deals certainly qualify as creative, if not clever. [Sandler O'Neill & Partners LP](#) Principal Emmet Daly worked on both transactions, and even though he thought they were quite advantageous for the buyer in the current environment, he is not sure you could call those deals the beginning of a trend simply because there are not many deals out in the market.

Still, participants at the conference encouraged banks to make an attempt to find ways to get deals done. Ajay Asija, managing director at [Fox-Pitt Kelton Cochran Caronia Waller](#), said buyers really should act opportunistically when it comes to deals because he truly believes that the current environment offers healthy institutions a "once in a lifetime" chance to pick up distressed deals on the cheap.

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