

Merger and Acquisition Landscape and Ten Application Filing Tips

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The views expressed here are not necessarily those of others in the Federal Reserve System .

Overview

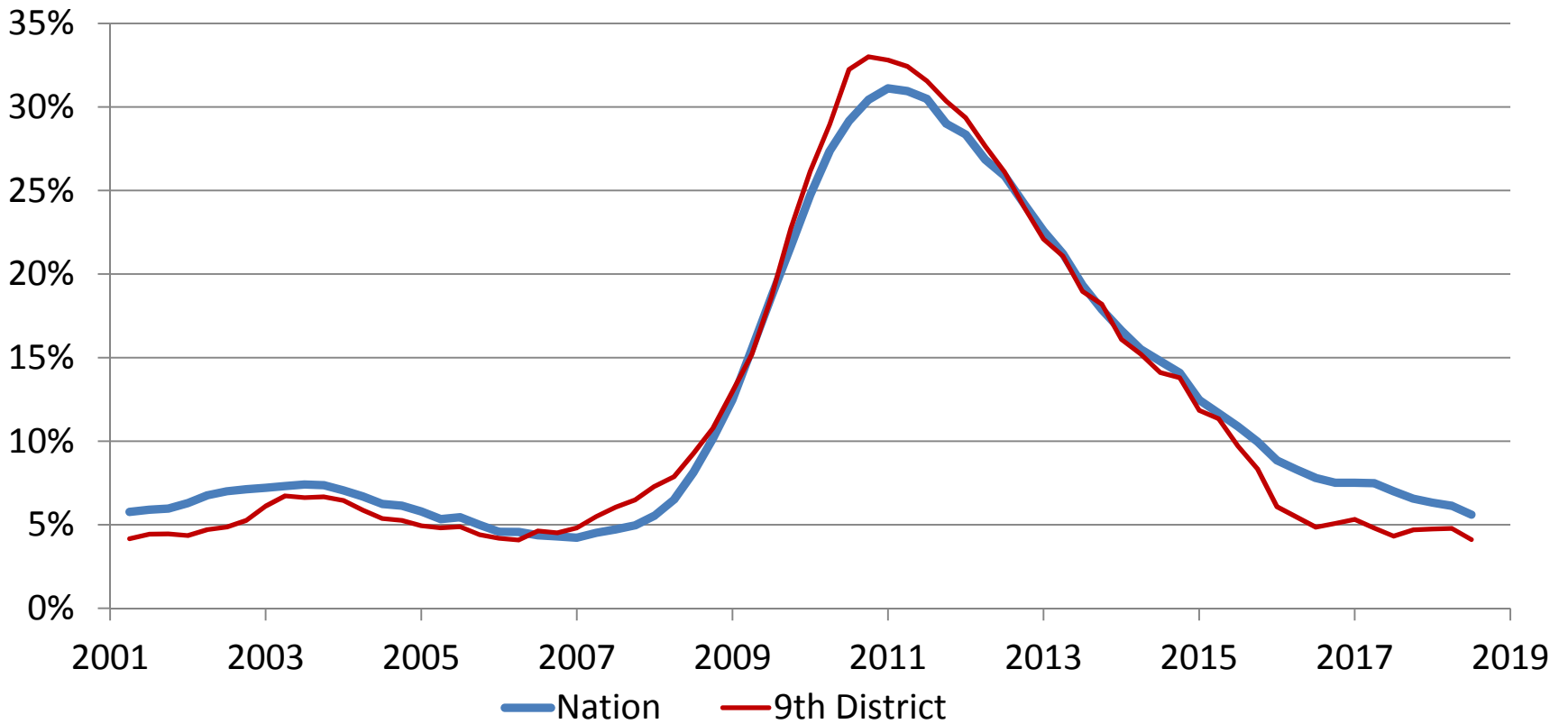
- Discuss key drivers
- Review historical activity
- Explore recent acquisition targets & deals

Commonly Cited Drivers of M/A Activity

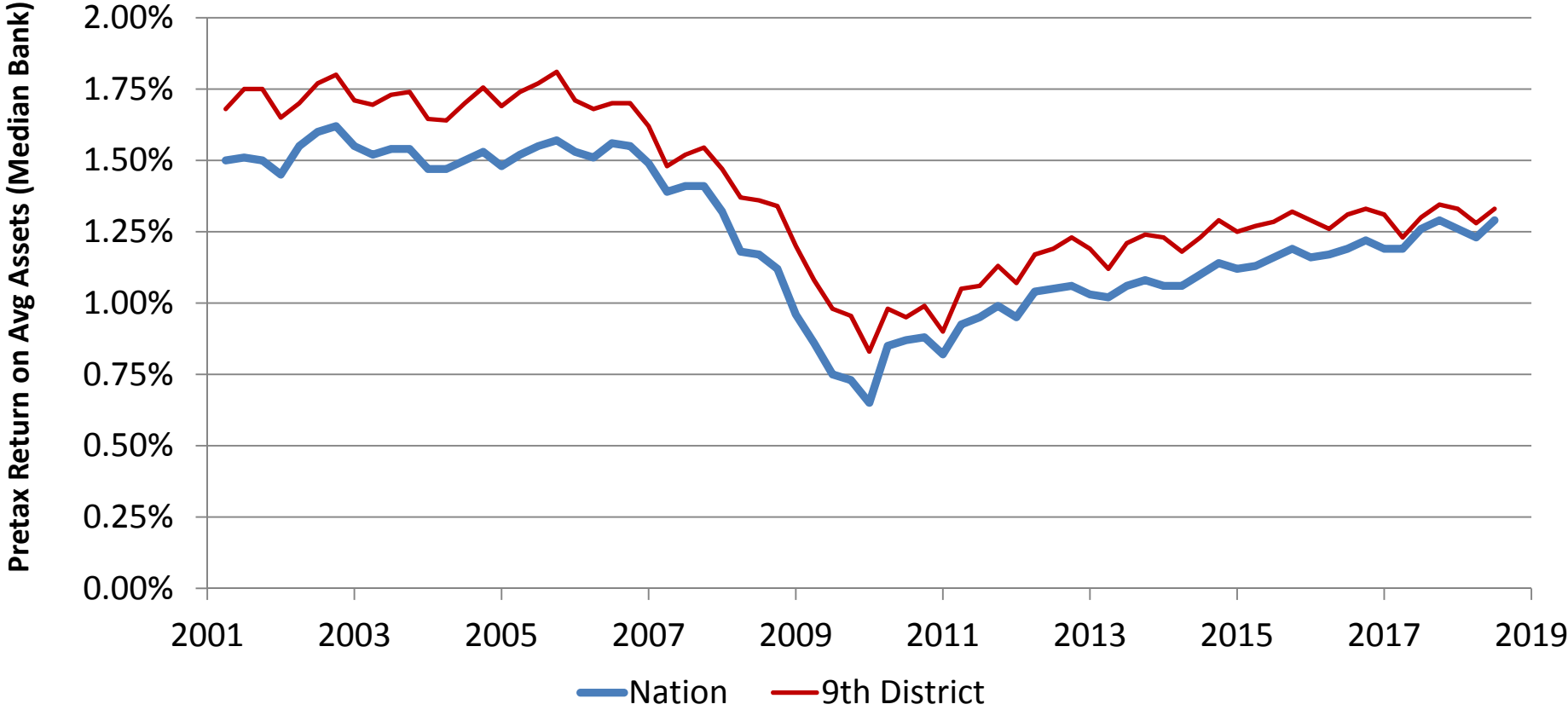
- Banking Conditions
- Economic Conditions
- Regulatory Conditions
- ***Conventional wisdom—better conditions, more M/A activity***

Banking Conditions are Generally Healthy

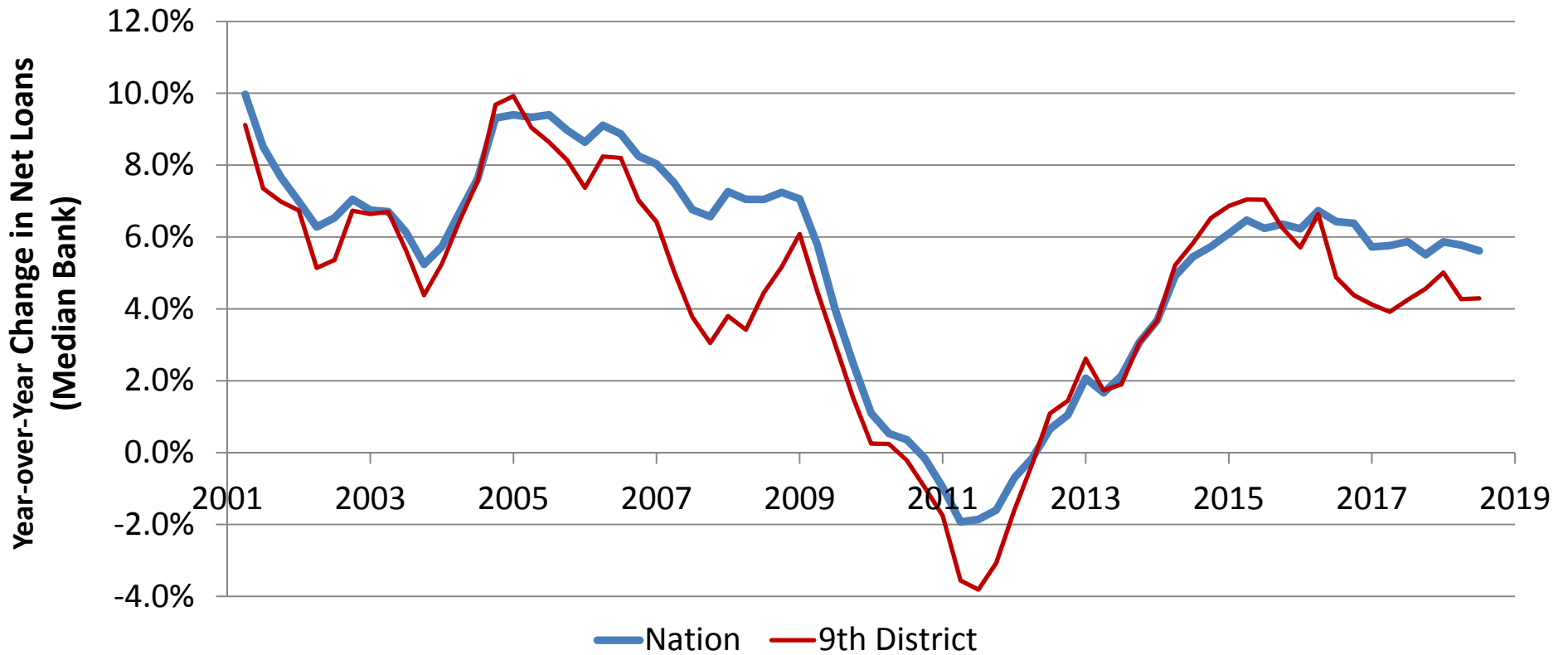
Percent of All Banks with CAMELS Ratings of 3/4/5



...although Earnings at the Typical Bank Have Not Yet Fully Recovered...



...and Loan Growth is Continuing to Decline

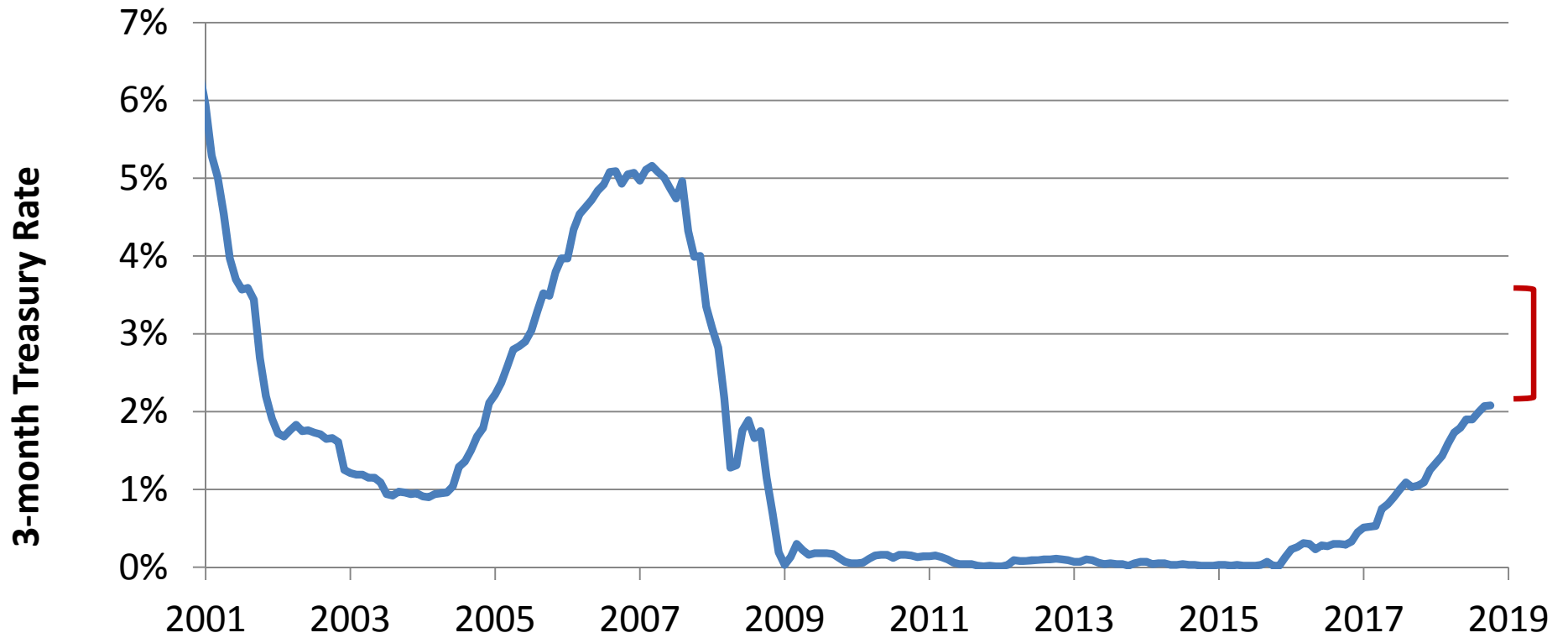


Economic Conditions – Robust

- Positive macroeconomic indicators
 - RGDP growth = **2.5%** [2017] ... **2.8%** [2018] ... **2.4% - 2.7%** [2019]
- ‘Muted’ impact from the tax bill
 - **30 – 90** bps over the next 3 years
- Bank equity prices have lagged a bit
 - Expectations for future earnings have fallen – 6% in 2019, 11% in 2020
- Most importantly...

Economic Conditions – Robust

Short-term interest rates have been steadily rising



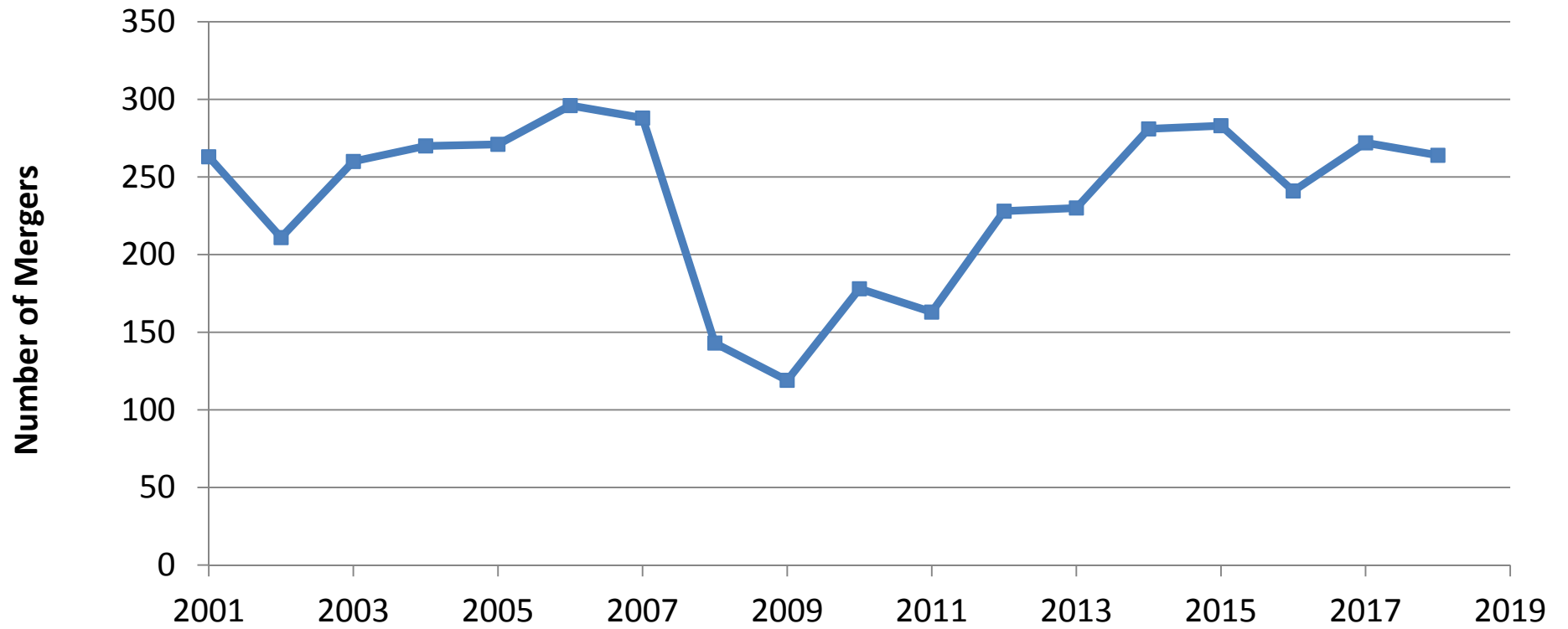
Regulatory Conditions – More Targeted

- EGRRCP Act
 - \$250 billion threshold for stress tests and most enhanced prudential standards
 - Exemption from Basel III for many community banks
- Additional targeting in the works
- Key positions have been filled (OCC, FDIC, BOG)...more changes to come

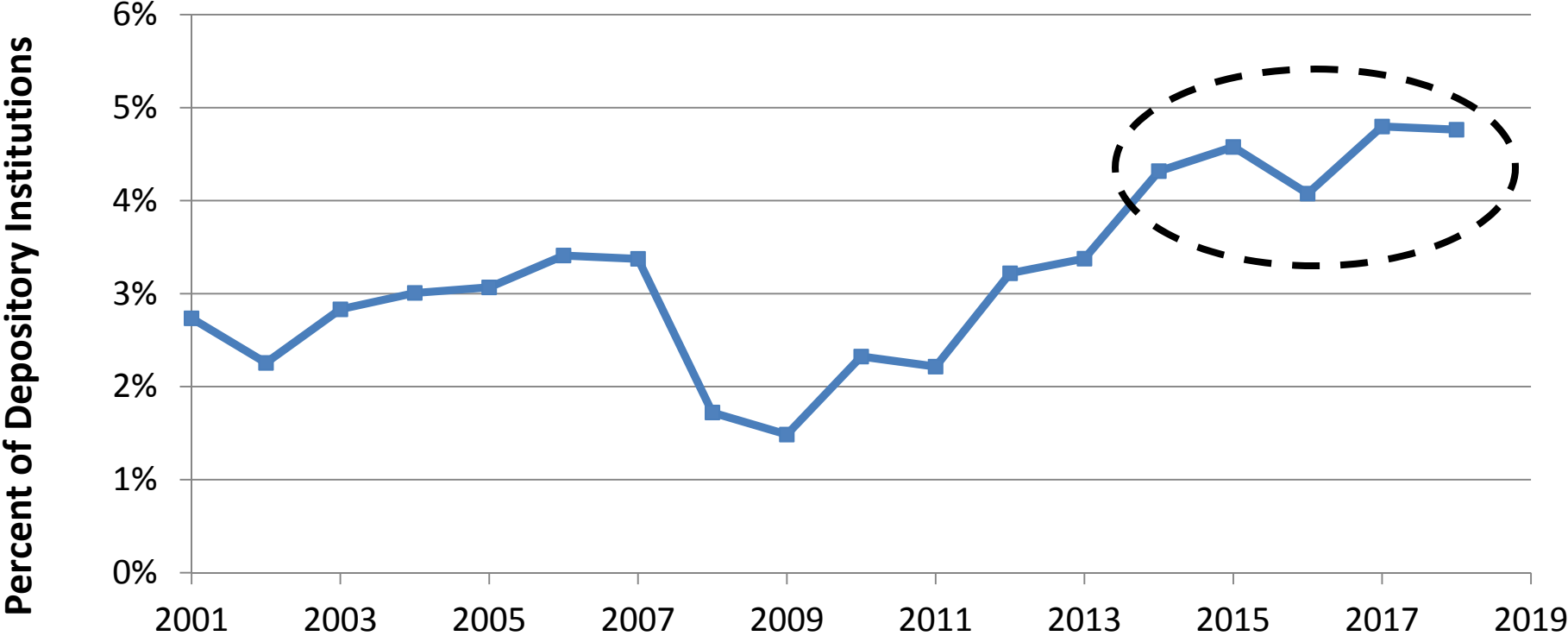
Commonly Cited Drivers of M/A Activity

- Banking Conditions – **HEALTHY***
- Economic Conditions – **ROBUST***
- Regulatory Conditions – **MORE TARGETED***
- *Conventional wisdom—better conditions, more M/A activity...**MAYBE?***

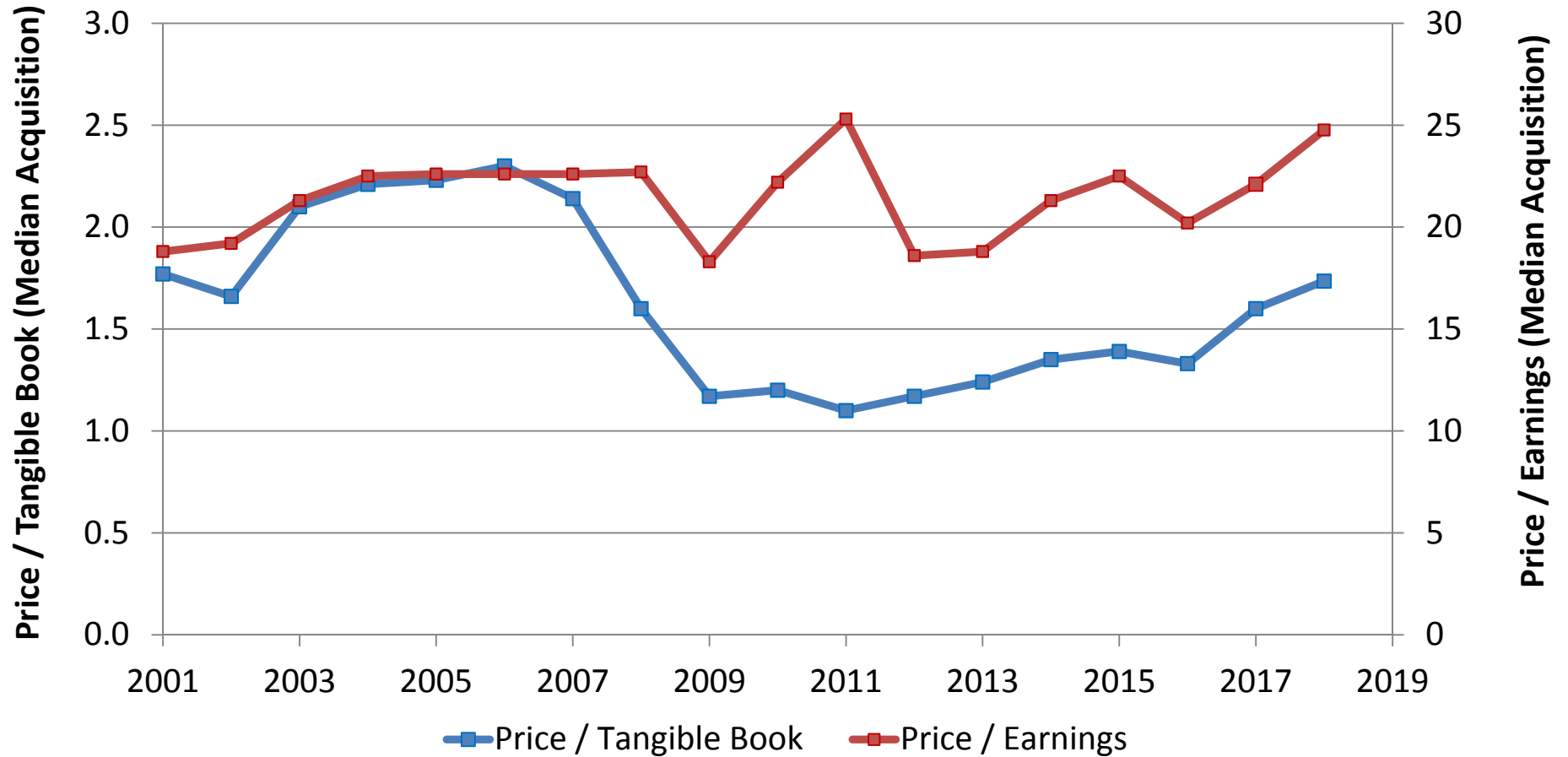
Historical Merger & Acquisition Activity



Recent M/A Activity Has Been High When Measured as a Percent of All Firms



Valuation Multiples Have Been Slowly Rising

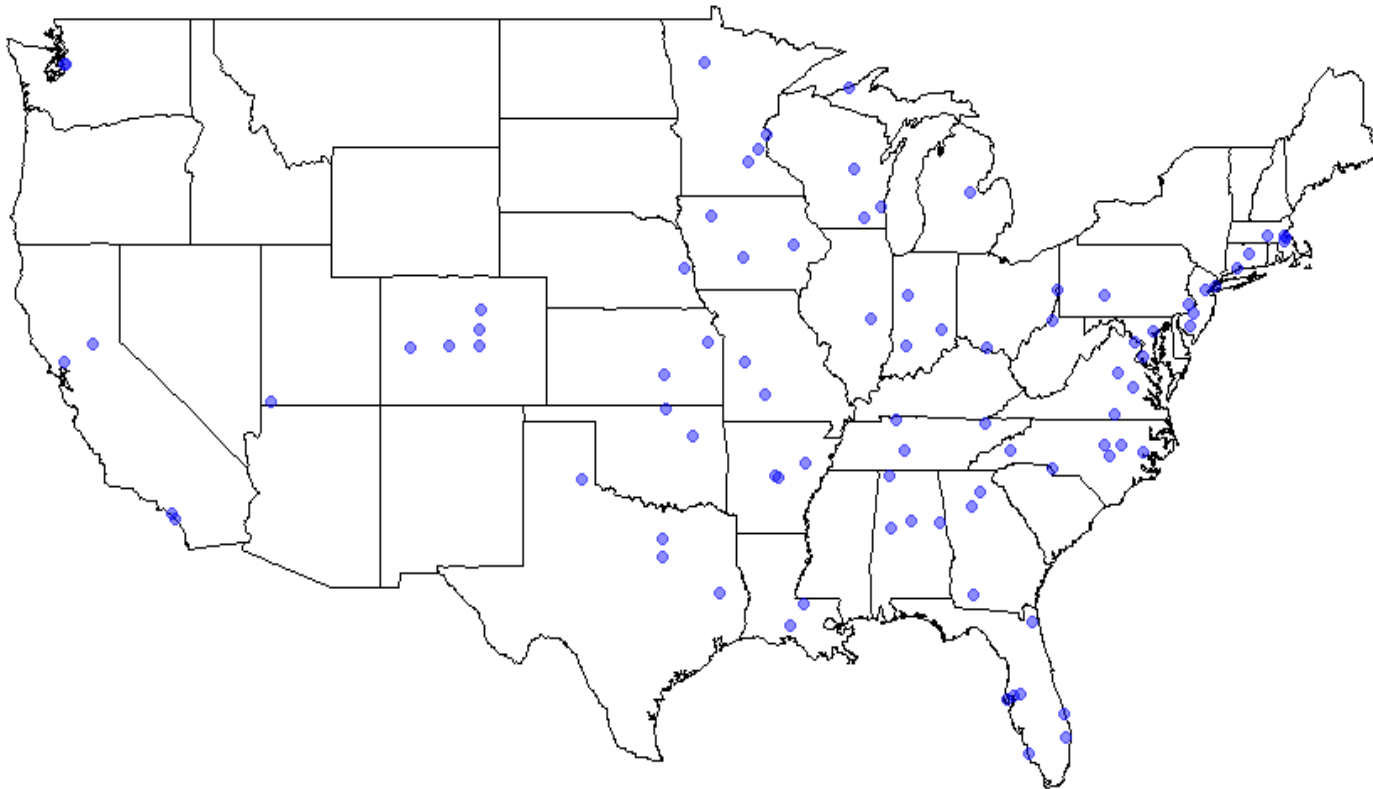


Summary of Recent M/A Activity



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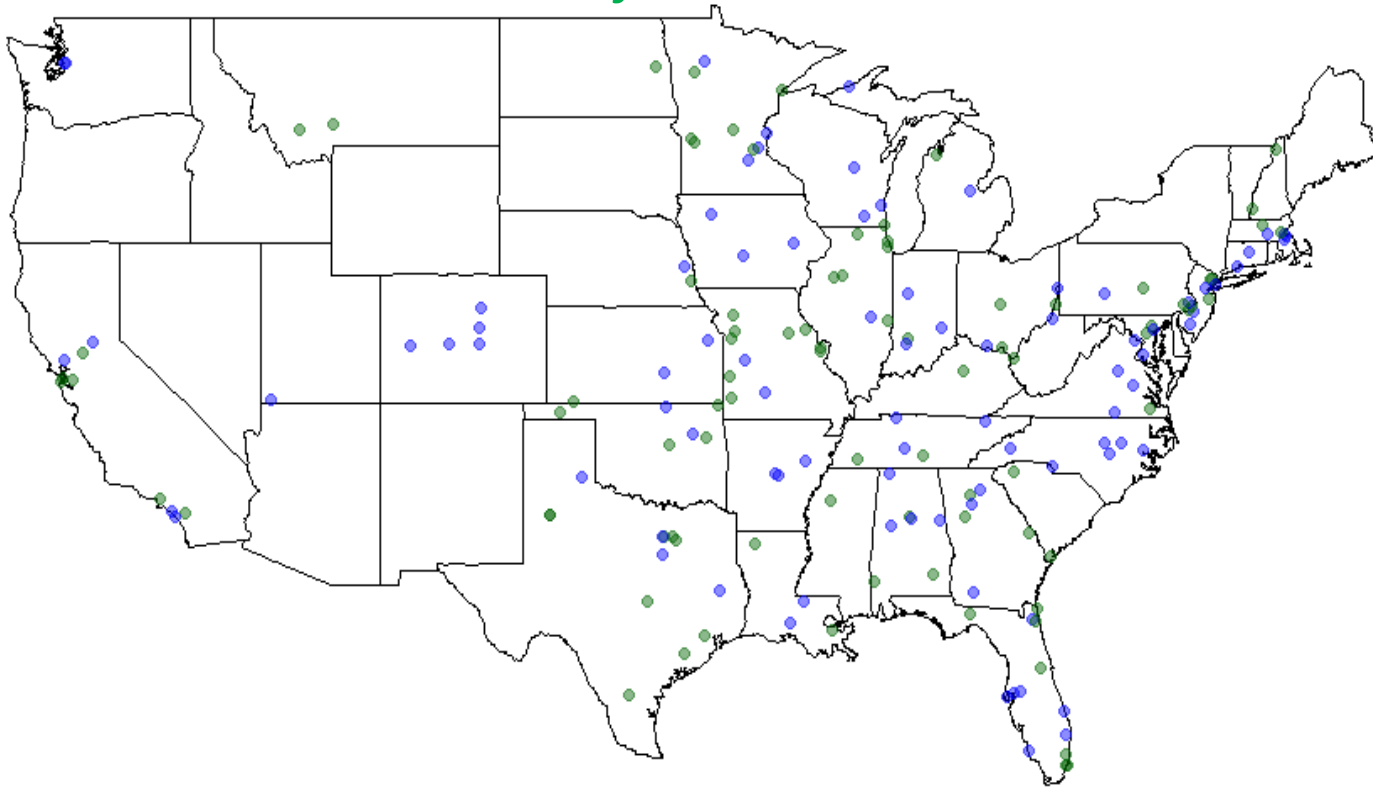
Middle 4 months of 2017 ---> 88 deals



Summary of Recent M/A Activity

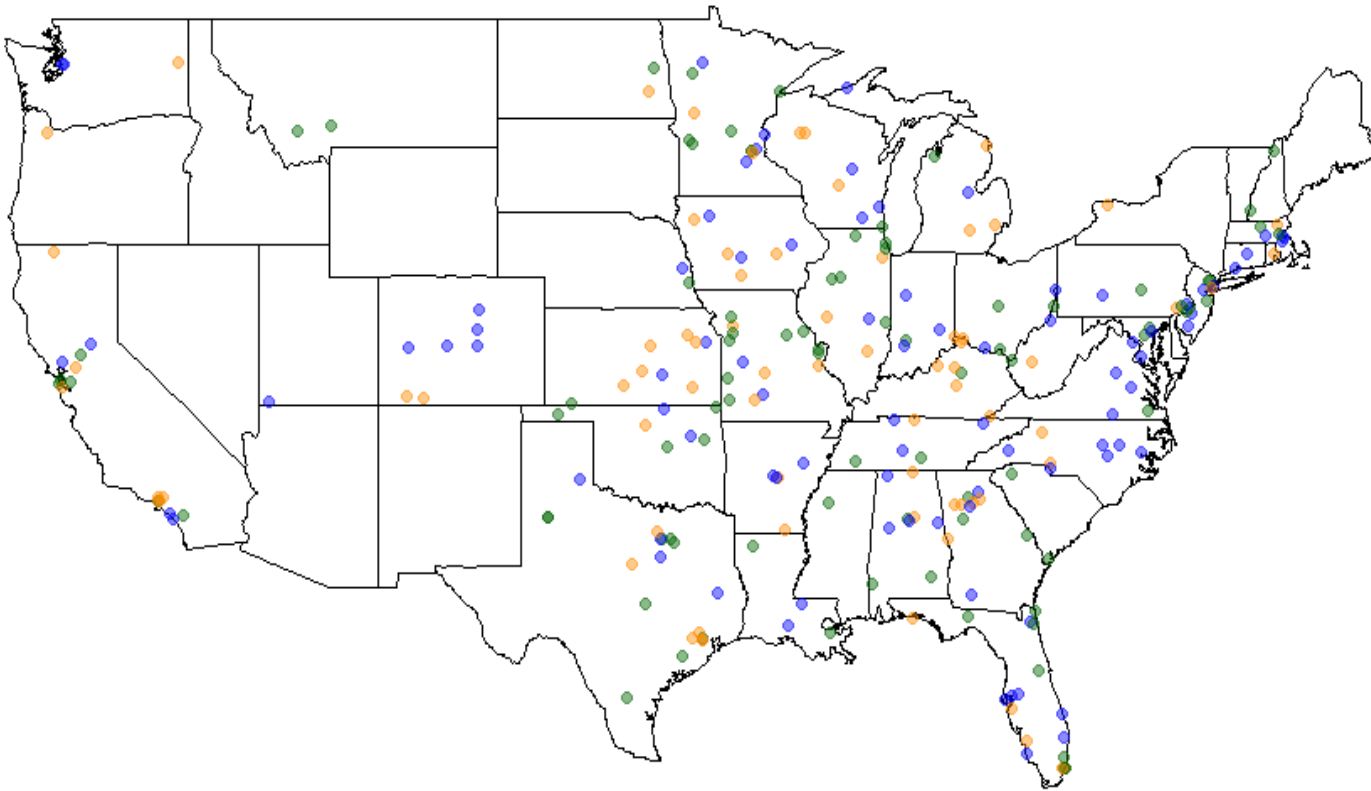
Middle 4 months of 2017 ---> 88 deals

Last 4 Months of 2017 ---> 87 deals



Summary of Recent M/A Activity

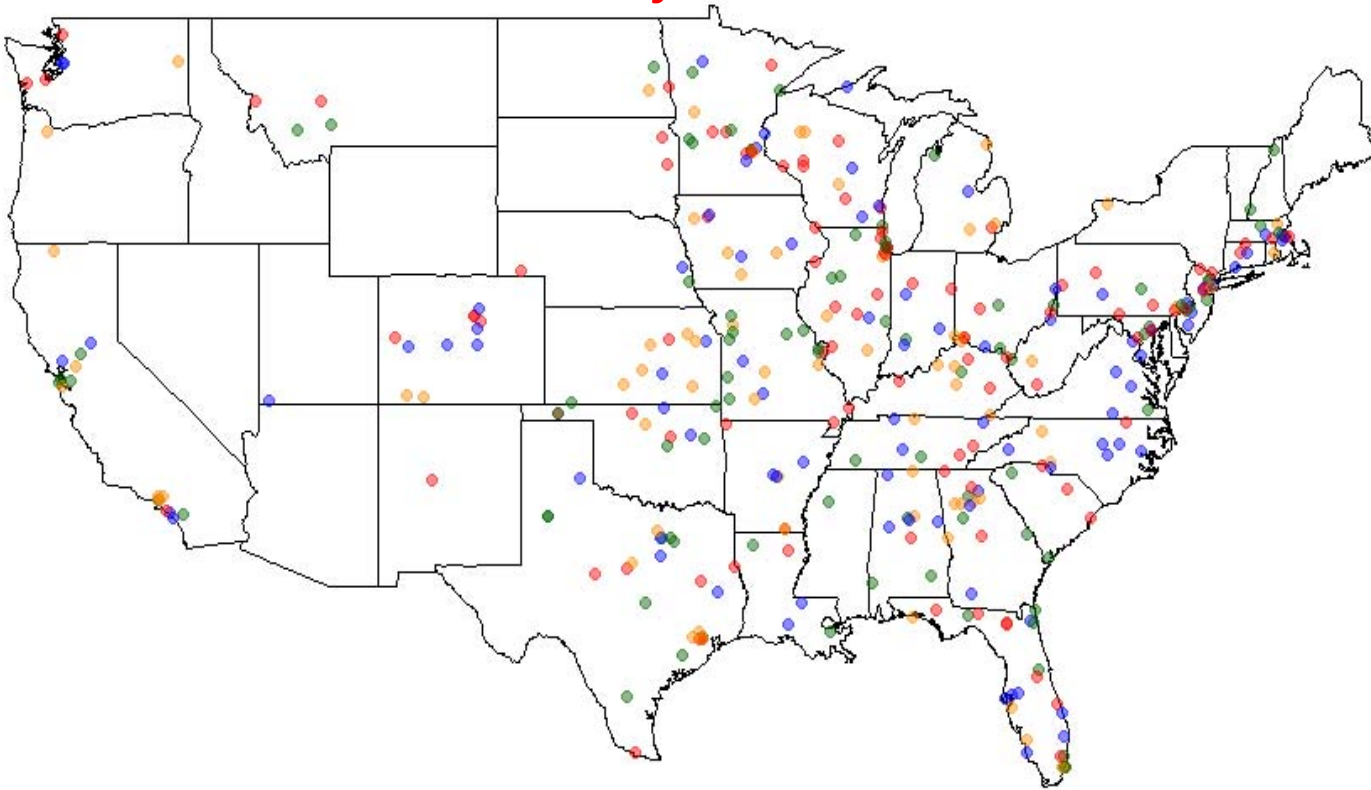
First 4 months of 2018 ---> 75 deals



Summary of Recent M/A Activity

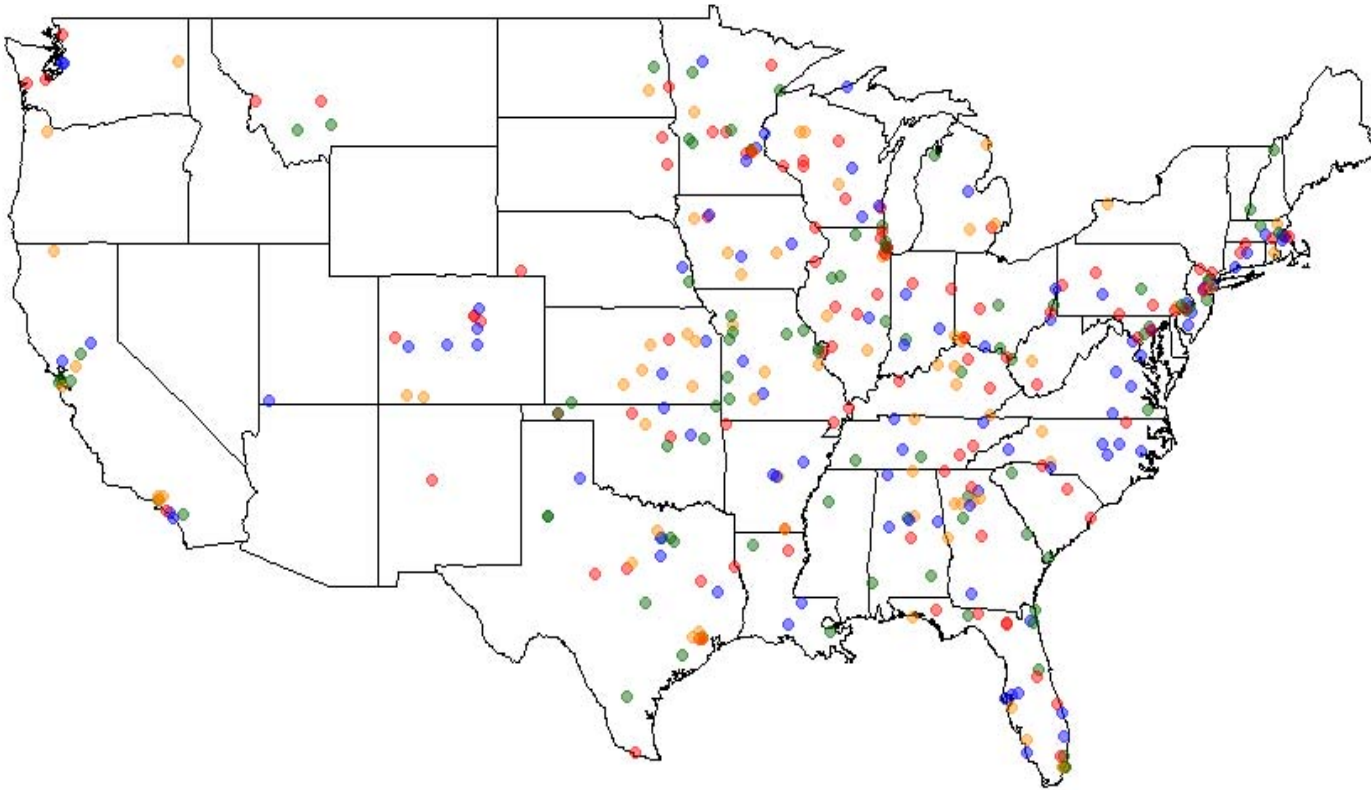
First 4 months of 2018 ---> 75 deals

Middle 4 months of 2018 ---> 101 deals



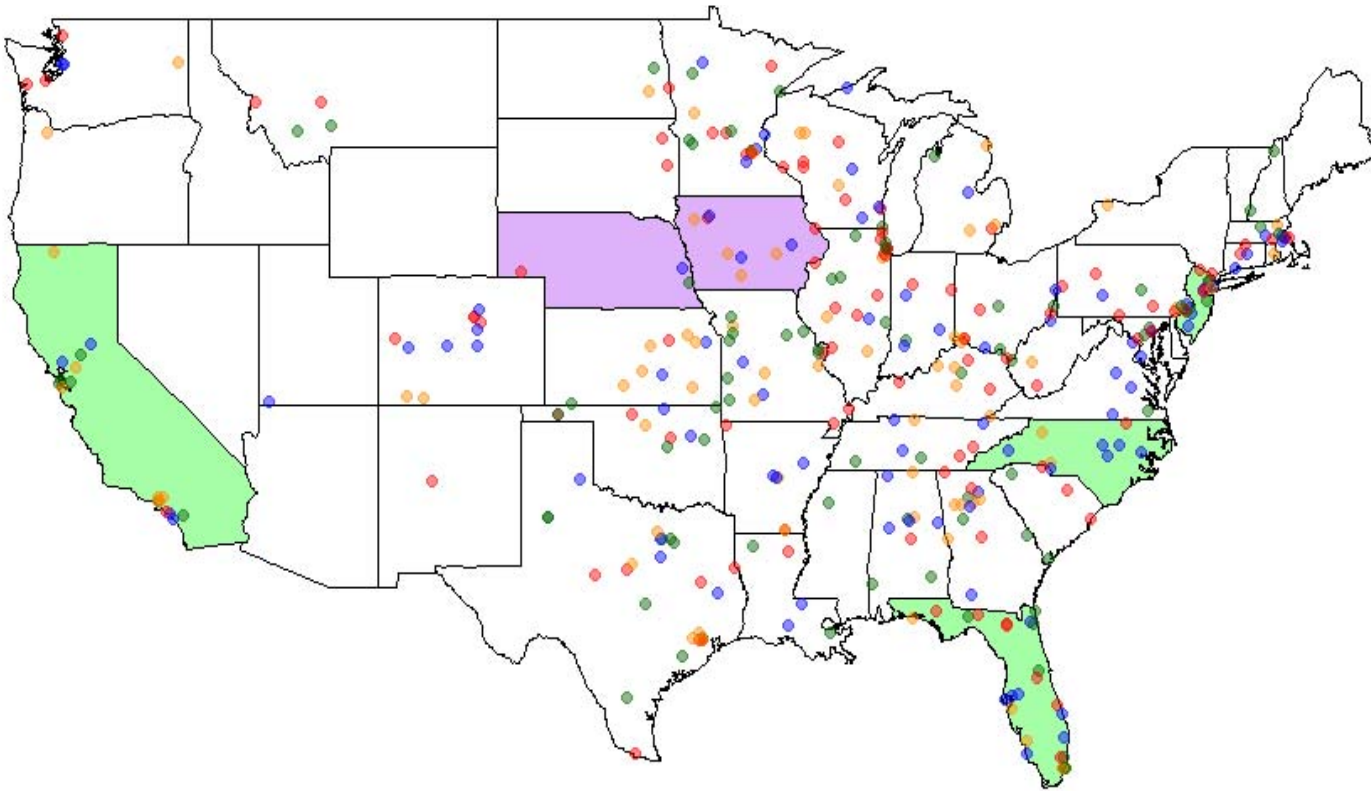
Summary of Recent M/A Activity

Highly correlated with the distribution of banks!



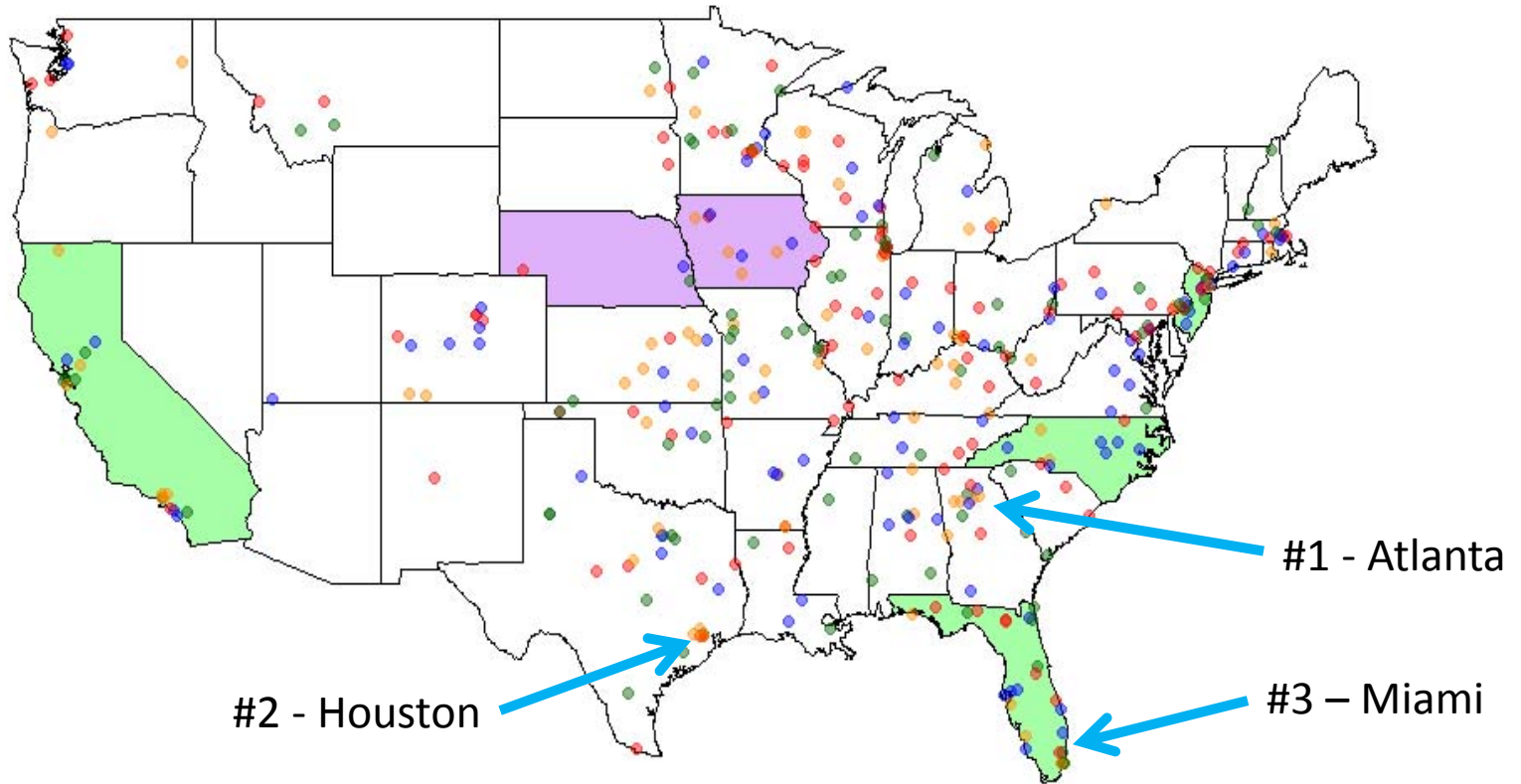
Summary of Recent M/A Activity

But certain areas have more (green) and less (purple) than expected



Summary of Recent M/A Activity

Noteworthy activity in 3 metropolitan areas



Summary of Recent M/A Activity

- 176 deals from 1/2018 – 8/2018
- “Private buyer” (no info) = 16
- Rural buyer, rural target = 22 (13%)
- Rural buyer, metro target = 23 (13%)
- Metro buyer, rural target = 31 (18%)
- Metro buyer & target (same area) = 36 (20%)
- **Metro buyer & target (different areas) = 48 (27%)**

Profile of Buyers (Current Deals)

- 160 **'identified'** buyers from 1/2018 – 8/2018
- 7 multi-bank buyers
- 153 **unique** identifiable buyers
 - 6 credit unions [median = \$1.2 B]
 - 7 independent banks [median = \$300 M]
 - 63 small BHCs [median = \$460 M]
 - 77 large BHCs [median = \$3.2 B]
- Only 11 were above \$10 B !

Profile of Acquired Firms (Historic Deals)

- FDIC / KC Fed studies on acquisition targets
- Results
 - **Most** are in metro areas (2/3)
 - **Lower** earnings (pretax ROAA, NIM) than peers
 - **Better** asset quality than peers
 - “**Lower**” risk according to balance sheet measures
 - Core deposit usage is higher
 - Loan/asset ratios are lower

Profile of Acquired Firms (Current Deals)

- Recent targets continue some of the trends
 - Roughly 70% are in metro areas
 - Pretax ROAA & NIM are slightly lower than peers
 - Nonperforming assets are 40 bps lower
- ‘Risk’ measures have been **higher!**
 - Core deposit usage is the same
 - Loan/asset ratios are higher
- Possible concern given valuation premiums
- Median target had roughly \$200 million in assets

Summary

- Conditions are supportive
- M/A activity is already at a high level
- Valuation multiples are trending higher
- Targets seem to be getting riskier

TEN Filing Tips

Suggestions to help make the processing
of your application or notice successful

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Five Tips You've Heard Before (because they're worth repeating)

- Use the **prefiling** process for complex or unusual proposals (see SR Letter 12-12)
- Wait to file until the applicant and/or its subsidiary bank has had a **ratings upgrade** (if it's in less than satisfactory condition)
- Expect greater scrutiny if the proposal will change the organization's **business plan** or its **risk profile**. Be prepared to discuss how the organization will ensure that appropriate risk management policies/processes/procedures and experienced personnel are in place.
- If the applicant or its subsidiary bank has a **less than satisfactory component rating** (e.g., a 3 rating for earnings or asset quality or IT), be prepared to discuss how the organization is addressing the issue and ensuring that the proposal is not a distraction to fixing the issue.
- Don't use **short-term debt** to fund an expansionary proposal, and, if the applicant is subject to the Policy Statement, a pro forma debt-to-equity ratio greater than 1:1 will result in **dividend restrictions**



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. . . . and Here are Five Other Tips to Remember





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Ask Us to Review a Draft Newspaper Notice

- Particularly if it involves complex or unusual proposals, transfers to trusts, or groups acting in concert
- Even small errors can require republication (e.g., absence of city, state information or template CRA language – “The Federal Reserve considers a number of factors in deciding whether to approve the application/notice including the record of the performance of banks we own in helping to meet local credit needs”)



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Ensure that You've Identified All the Transactions Needing Approval/Parties Involved

- Bank Holding Company/Savings and Loan Holding Company acquisitions may have “hidden” nonbanking activities notice requirements
- All members of a group acting in concert acquiring shares must be identified as notificants, even if some own only a small number of shares



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Consult with Bank Regulators to Determine if Their Prior Approval is Needed

- Depending on state law, a change in control at a bank holding company may require state approval
- If a subsidiary bank proposes to pay a dividend to help fund an acquisition, determine whether regulatory approval is required and, if so, don't delay in filing



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Submit Name Check Information in Advance of a Filing

- If anyone is subject to a background (name check) investigation, have them submit fingerprints before the filing is submitted
- Ensure that individuals accurately and timely complete the Interagency Biographical and Financial Report (IBFR)



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Make Sure That When We Receive the Filing, We've "Received" the Filing

- Our business day ends at 3:00 p.m. Central. Filings received after 3:00 p.m. are considered received the next business day
- Missing or unsigned documents won't necessarily result in our concluding that the filing is not "received" for processing, but it adds to the additional information request(s)
- If submitting a filing in paper form, include copies (call us to determine how many are needed)



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Bonus Tip! Sign Up to Use E-Apps

(https://www.federalreserve.gov/supervisionreg/afi/eapps_sign_up.htm)

- Information gets to Board staff faster
- Less cumbersome than paper, particularly if large filings
- Submit documents almost 24/7 (Sunday mornings down for regular maintenance)



Recent Revisions to FR Y-3 Application Form

- New Informational Items Include –
 - A List of All Regulatory Approvals and Filings Required for the Proposed Transaction
 - Copies of Other Regulatory Actions and Findings Regarding the Proposed Transaction
 - Information Regarding Litigation or Investigations Involving Applicant or Target
- Informational Items Removed Include –
 - Description of the Due Diligence Review Conducted on Target Operations