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Observations of Merger & Acquisition Activity and Pricing

By Zachary Lundquist

Merger and acquisition activity by banking organizations, both in the Ninth Federal Reserve District and nationwide, has increased significantly since bottoming out in 2009. Prices for transactions, while increasing from lows in 2010, have not returned to pre-crisis levels. In this article, we briefly summarize current trends in M&A activity, defined as bank mergers and acquisitions of additional institutions by existing bank holding companies; provide insight into the most common obstacles we see when processing applications by HCs, and give tips for avoiding these pitfalls.

M&A Activity Trends

In 2009, the Federal Reserve Bank of Minneapolis approved a total of four M&A transactions, two of which involved HCs with less than $1 billion in total assets. In 2016, these numbers increased to 17 transactions, with 15 involving banks less than $1 billion. There is a general trend of increasing volume of M&A activity and a concentration involving community banks from 2009 through 2016, though the specific numbers vary each year. Data available from S&P Global suggests similar, though less pronounced, trends on a national level.

The median transaction price as a percentage of tangible common equity in Ninth District states for transactions involving banks less than $1 billion increased from 98 percent of tangible equity in 2010 to 119 percent in 2016. (Pricing data is from S&P Global and is available by state rather than Federal Reserve district. As such, these figures include all of Michigan and Wisconsin in addition to Minnesota, North and South Dakota and Montana.) This compared to 120 percent and 128 percent in 2010 and 2016, respectively, for similar transactions nationwide. The 2016 prices, while improved from recent lows, remain well below the levels seen prior to the crisis. In 2007, for example, the median price for similar transactions in the Ninth District states was 234 percent of tangible common equity. The median price of acquisitions for small institutions within Ninth District states has increased since 2010 to $17 million from $3.1 million, suggesting buyers' appetites for larger acquisitions.

Avoiding Application Obstacles

We consider a number of factors related to the target institution(s) as well as the applicant institutions(s) when reviewing an M&A application. Weaknesses or issues identified in these factors could delay processing or become a barrier to approval. Two areas that most commonly raise issues are 1) financial and managerial factors and 2) provisions within purchase agreements. We discuss these two areas in more detail below.

We review financial and managerial factors in light of historical performance and future prospects. HCs proposing an acquisition should outline plans to address any weaknesses in asset quality, capital, Bank Secrecy Act and consumer compliance, or CRA performance at the target as revealed by their due diligence. In addition, HCs need to demonstrate they can serve as a source of strength to their subsidiary depository institution(s) following consummation of an acquisition. This includes demonstrating the ability to serve any debt incurred in the transaction. If the HC is relying on earnings or growth projections that differ from historical levels, the application should explain the basis for the projected improvement. The applicant should also detail any planned changes in directors and management, and the business plan of the applicant or target. When proposing changes in business plans, HCs should detail financial and managerial resources in place to support anticipated changes and explain controls to be implemented to ensure continued safe and sound operations.

Two types of provisions in purchase agreements commonly require action by applicants: provisions that restrict a target's activities and provisions related to information sharing. Provisions restricting the target's activities could allow the buyer to control the normal business operations of a target prior to receiving authorization to do so. Accordingly, restrictions need to be limited to unusual activity; the target must be able to operate within its normal course of business. With respect to information sharing, we are concerned with the sharing of Confidential Supervisory Information (CSI) and access to attorney client privileged information. CSI is supervisory specific information such as examination ratings and report content (including classifications), certain correspondence with regulators, and certain supervisory actions. Information sharing provisions should clearly prohibit sharing of CSI and limit sharing of attorney client privileged information to that needed to complete reasonable due diligence.

For additional detail regarding these and other factors, review the Federal Reserve System's Supervisory Letter SR 14-2 (Enhancing Transparency in the Federal Reserve's Applications Process). Keeping these factors and suggestions in mind prior to submitting an M&A application will facilitate timely processing of your application.

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