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Insights: Perspectives

The Outlook for Bank M&A Activity

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4 KEY TAKEAWAYS

"The Outlook for Bank M&A Activity"

Jefferies LLC Bank Research Analysts **Ken Usdin** and **Casey Haire** recently hosted a call with Kilpatrick Townsend Partner Gary Bronstein. Mr. Usdin, Mr. Haire, and Mr. Bronstein, who leads Kilpatrick Townsend's Financial Services team, discussed "The Outlook for Bank M&A Activity."

Key takeaways from the discussion include:

1

As good as it gets? There is growing sentiment among bank executives and boards that the current fundamental environment is "as good as it gets", which could drive more M&A deal volumes. With regional bank stock indices at all-time highs, buyers have stronger currencies and sellers are closer to any theoretical takeout number. Further, the regulatory environment has improved, with the passage of the Crapo bill (S. 2155) removing stigmas around crossing the $50 billion asset threshold. Despite an upbeat message overall, sellers still have high-price expectations, which has held up deal volumes to an extent. Also, there are more sellers than buyers among smaller banks and more buyers than sellers among the larger ones. This will likely keep deal sizes smaller until existing valuation multiple gaps converge.

M&A outlook varies by market. There is likely to be a strong amount of activity in the Midwest given a still-fragmented landscape with a number of potential sellers. The Southeast continues to be a busy given attractive growth characteristics. While New England's economy is fine and the bank landscape is fragmented, bank M&A activity has been stagnant. Interestingly, there is little evidence of buyers targeting lower-tax states/markets in the wake of tax reform.

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Seller rationale: succession planning and regulatory/tech costs. Succession planning continues to play an important role in driving M&A activity, as banks without a CEO heir apparent seek strategic partners. Despite deregulation, there are still regulatory-related concerns to motivate bank buyers/sellers. Specifically, banks below the $10 billion threshold are still wary of the expense burden tied to the prospective loss of some debit interchange revenues and are looking to buy their way well past the line. While hopes for more mergers-of-equals abound, there are aspects of such negotiations that tend to stall transactions due to cultural considerations (i.e. choices around CEO, bank name, headquarters location). Deposit growth/mix/quality will also remain important. In contrast, the Current Expected Credit Loss (CECL) reserving rules -- with a 2020 implementation -- are not seen as an M&A catalyst, with banks still in the planning/ discovery phase.

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The tech spend is becoming a more significant driver. Regional banks continue to spend on technology as they hope to keep pace with the bigger tech budgets of larger banks. After years of community banks taking deposit market share, the bigger banks have reversed the course, which could in part be attributed to investments in digital channels/distribution. Smaller banks have attempted to keep pace by making their own investments or by partnering with outsourcing/FinTech providers. As with every tech wave, some will fall short of the required upgrades and opt to find a strategic partner to provide an adequate delivery model to depositors.

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For more information, please contact Gary Bronstein at gbronstein@kilpatricktownsend.com

www.kilpatricktownsend.com

Related People



Gary R. Bronstein
t 202.508.5893
gbronstein@ktslaw.com