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Bank M&A on Pace for Best Year Since 2008

Merger momentum is finally building in the banking industry.

Banks announced 136 whole-bank deals in the first half of 2014, representing an 18% increase from a year earlier, according to SNL Financial. The aggregate value of those deals topped $6 billion, a 33% spike from the first six months of 2013.

Dealmakers expected 2014 to be relatively stronger than prior years in terms of activity, and that optimism could be rewarded if the current pace continues.

"M&A is getting back to a steady state like we had before the banking and real estate crisis," says Charles Crowley, a managing director at Boenning & Scattergood. "The activity is largely among the smaller banks and, for midsize community banks with a good currency, there are a lot of deals that make sense."

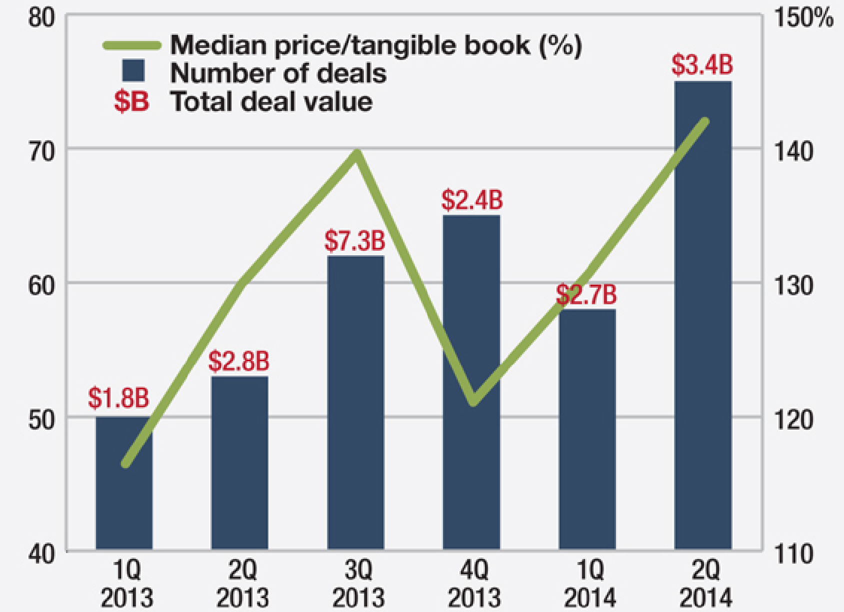
The banking industry is on track to have its strongest year for M&A since the financial crisis, says Michael Rose at Raymond James.

The research team at Raymond James calculated the number of announced deals as a percentage of total banks at the start of the year. At 4.03% annualized, activity at mid-2014 is the most robust since the rate was 4.61% in 1998, Rose says.

The second quarter was particularly strong. With 77 deals, it was the busiest quarter for M&A announcements in at least five years.

M&A's Comeback Bid

The number of bank deals and premiums are on the rise, suggesting that buyers' and sellers' expectations are more closely aligned and M&A momentum will accelerate



Source: KBW

(Merger activity seemed to stall last year; deal activity at mid-2013 was flat compared to the first six months of 2012.)

Another encouraging sign in this year's data is pricing, which has started to improve.

Dealmakers were cautioning sellers a few years ago to temper expectations, warning that a two-times tangible book payday would be unlikely. The average deal in the second quarter was priced at 149% of the seller's tangible book value, up from 119% in the fourth quarter of last year.

Improved pricing largely reflects a stronger currency for buyers that can now pay more, industry observers say. And market continues to reward consolidators that execute on deals that promise value for shareholders, says David Olson, chief executive of River Branch Holdings, a Chicago investment bank.

Still, industry observers say they don't think prices will continue to build up too much in the near term.

Bank M&A on Pace for Best Year *continued*

"Pricing is directly dependent on the trading values of the buyers and the market valuations of the buyers remained consistent in the second quarter," says Bill Hickey, co-head of investment banking at Sandler O'Neill, which was involved in 28 deals through mid-2014. "That means pricing is not going to deviate from the last quarter pricing."

Hickey tempered his remarks by saying there could be some buyers who could pay up because they are quickly building capital or are getting anxious about growing their balance sheets.

Analysts at Raymond James also delivered a reality check in their recent note to clients.

"We continue to believe a return to the 'glory days' of management teams and boards of directors expecting more than three times book value for their franchises is unlikely to return in the short to intermediate term," they wrote.

Industry observers are also throwing cold water on the notion that the industry will see an uptick in mergers of equals.

Such deals seemed extremely popular late last year and in early 2014, prompting more chatter among banking experts. That trend was short-lived, industry observers say, and is related to an increase in pricing.

Mergers of equals are terrific in lower-price markets because companies can rationalize a lower premium by pairing with a like-sized company that is similarly situated. Such deals can be filled with upside potential as the companies cut expenses and benefit from economies of scale. But MOEs have lost their appeal as stock prices across the industry have risen.

"My candid view is that, as premiums continue to rise, it is harder to do lower-priced MOEs because the boards of either company wonder, 'Why are we exchanging our equity near market value when there might be a significant premium out there?'" Hickey says. "There was a more active MOE market when the premium deal wasn't out there."

"There were a lot of MOE deals and discussions, and it was a function of banks saying that they not only needed to get bigger, but they wanted to get bigger faster," Olson says. "With the ultimate takeout premium on the rise, the conversation is totally different."

Another game changer could be the return of bigger banks to M&A, industry observers say.

David Turner Jr., chief financial officer of Regions Financial (RF), said at a conference hosted by Morgan Stanley last month that the Birmingham, Ala., company was tentatively considering deals.

"We also are to the point where we want to start looking … at opportunities to acquire complementary portfolios, nonbank businesses and starting to at least think about bank M&A," he said.

Similar conversations are happening behind closed doors, Olson says. "Some of the regionals are fairly aggressive in letting people know they are open for business," he says.

Banks like BB&T (BBT) in Winston-Salem, N.C., or New York Community Bancorp (NYCB) could eventually return to M&A, banking experts say.

The larger banks might be primping and preparing for M&A, but Hickey says he is skeptical about anything happening among the larger banks this year. "I think it is a 2015 event," he says.

by Robert Barba