AMERICAN BANKER

October 18, 2013

It's a Better Time to Sell Your Bank Than You Think

This might be a normal M&A market after all.

Many banks complain that multiples are still too far below precrisis levels to consider selling themselves, but they are wrong, says David Olson, the chief executive officer of River Branch Holdings, a Chicago investment bank.

When adjusted for the credit writedowns buyers are anticipating, current valuations are on par with the prices commonly seen in the last few decades, he says.

Olson spent the 1990s as co-head of Donaldson, Lufkin & Jenrette's financial institutions group and its Chicago investment banking office. He then spent several years working in Asia for companies such as Credit Suisse and Guggenheim Merchant Banking. He returned to advising banks in the U.S. when he started River Branch in 2010.

In an interview, Olson discussed how buyers are using their richly valued stock to do deals, the asset size banks see as optimal and the fear of the market turning irrational.

The following is an edited version of the conversation.

What's your take on M&A so far this year? The volume remains low, but there has been a pick up in early-stage activity and there are some heartening signs. For example, there has been a healing of the buyers. They are performing better, both in operating terms and in the market. The post-announcement rewards [e.g. increases in buyers' stocks] are a positive factor.

Will these post-announcement increases in buyers' stocks be the launching pad for further M&A? It represents a nice change. It is too early to tell if it lends confidence to other buyers.

Is that something we've seen in previous cycles? It has happened in other times, but it is more often the case, especially when deals get pricey, that buyers initially trade off. They typically recover in the lead-up to the closing and certainly after closing if the deal has made good sense.

So does this indicate a pricing equilibrium? It means buyers are doing good deals. The buying strategy right now is convincing the seller that they are catching a rising star. It is often presented as "you may not be getting the price you wanted, but you're catching a faster-moving train."

In trading-multiple land, there is an advantage to being a midsize bank and you can see that right in pricing.

How do you define midsize? Most people consider mid-caps as having between $1 billion and $5 billion market capitalization. They are trading now at book and a half, where micro-caps are trading just over book value. It is now easier for a buyer to convince a seller about the advantages of size in the trading markets. That is for sure driving deals for selling boards who are frustrated that they are flying under the radar.

ALL ABOARD? Many bank buyers are telling sellers, "You may not be getting the price you wanted, but you're catching a faster-moving train," says David Olson, CEO of River Branch Holdings, a Chicago investment bank.

The industry used to be described as a barbell. Do you think consolidation is going to end up making it look like a rolling pin? If you were to poll bank CEOs about the optimal bank size given economies of scale, regulatory and compliance thresholds, product offerings—consider it all, it would be $10 billion to $20 billion in assets. That is what I hear as the optimal size. I've also heard very big banks say it is closer to $50 billion. My own view is that it is somewhere in between, probably $15 billion to $25 billion. Notice, no one says $2.3 trillion—JPMorgan's asset size.

Better Time to Sell Your Bank *continued*

What does that do to the $1 billion-to-$10 billion crowd? There are very few CEOs of $1 billion-asset banks who feel they are the right size. They need to either grow or get out.

We see that the premiums are up a little bit this year. Credit marks still drive pricing. When the buyers come in, they mark the credit book to market. On an adjusted basis for those credit marks, the average price to tangible book value is much closer to book and a half. Now, if you exclude two peak M&A markets of 2004 to 2007 and 1997 to 1998, the average price to tangible book was slightly over one and a half for the last 25 years. We had an "a-ha" moment from that. If you look at the after-credit-mark pricing of today, it is very much on par with an average M&A market. It is a way of saying to a seller, 'This isn't such a terrible time to sell your bank.'

There is a lot of fear about the market becoming irrational. There is always that fear. Obviously, as buyers heal and they can pay more without dilution, that drives prices up. That is what happens in peak markets. What happens, though, is that trading multiples don't stay high forever. But it is natural—when multiples are up, buyers may reach a little bit on what looks like at first blush higher pricing.

What else could cause consolidation in the next year or so? Sellers are tapped out. You've heard fatigue—that is one motivator. There is management succession. Senior management is at or near the end of their career. Also, bank M&A is rarely cash only. In other industries, M&A often involves a lot of cash, but because of capital rules banks just can't do it. It means that the sales process is different. We aren't just auctioning something off for cash. It means we are making an investment decision. I always talk about that when I meet with selling boards.

Ed Wehmer, chief executive of Wintrust Financial, recently said the pricing expectations in Chicago have risen because of the MB Financial-Taylor Capital deal. No question. Everyone looks to the richest deal as the new bar. But MB is another example of a buyer who enjoyed a nice multiple and was able to pay that price for Taylor.

What's River Branch been up to this year? We advised on the successful recapitalizations of Standard Bank and the Metropolitan Bank Group. Both were complex transactions where fresh capital will reinvigorate once proud franchises.

We've worked on a number of more traditional transactions, including the First Merchants/CFS deal in northern Indiana. We are also working on some nonbank deals—we are advising the buyers of International Lease Finance, American International Group's airplane leasing business. We also advised Capitol Bancorp on the sale of various subsidiaries including the Talmer announcement.

By Robert Barba