

## SNL Blogs

# KBW sees shift in deal motivation and more bank M&A in '15

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While the timing remains unknown, an interest rate hike is widely anticipated later this year — something that is bringing into focus the importance of core funding and motivating bank buyers to home in on deposit-rich targets while on the hunt for mergers and acquisitions, analysts at Keefe Bruyette & Woods say.

This marks an evolution of sorts, with many would-be buyers no longer focused foremost on asset generation as the driving catalyst for deals (though that remains an incentive for many) and adds a layer of M&A stimulus that is likely to help drive greater deal activity in 2015 than the previous year, Keefe Bruyette & Woods analyst Michael Perito told SNL.

“It is a shift that we are already seeing,” Perito said. “And I think you will see more of this, more looking for targets to enhance funding ... and I think we’ll see more deals this year.”

That is notable because 2014 was the most active M&A year in bankland since 2006, he added. There were 291 bank deal announcements in 2014, up from 227 the year before, according to an SNL analysis.

SNL tracked 60 whole-bank deal announcements in the first quarter of this year — four more than announced in the same period of 2014. “So already we’re tracking higher,” Perito said, adding that in recent years M&A activity has tended to gather momentum as the year wears on. “And I would expect that to happen this year, too.”

In March, for example, Phoenix-based Western Alliance Bancorp. said it planned to buy Bridge Capital Holdings, a Silicon Valley lender, to strengthen its footprint in the booming technology markets of Northern California and to acquire a low-cost deposit base that would bolster the buyer’s liquidity and margins. More than two-thirds of the target’s deposits are in noninterest bearing accounts.

“The strong deposit base is an important part,” Western Alliance CFO Dale Gibbons told SNL after the deal was announced.

Gibbons and many other bankers are watching the Federal Reserve closely, expecting policymakers to start raising short-term rates as soon as the June meeting or next fall. Banks that bolster their core deposit bases, and in doing so lower their funding costs, are more likely to be better positioned for when rates climb as they could then benefit more notably from higher rates on loans, generating more interest income.

“Although near-term benefits of acquiring solid deposit franchises can sometimes appear to be more limited given the often excess

lending capacity at these banks, in the face of eventually rising rates, we believe these transactions will be viewed more favorably in the future, both in terms of net interest margin (NIM) performance [and] overall franchise value,” Keefe Bruyette & Woods analysts led by Perito wrote in a March report summarizing the state of bank M&A.

“Conversely,” Perito and company continued, “we believe that many banks could also explore selling because of long-term funding challenges, which we have already seen happen on multiple occasions in the past couple of years, including CapitalSource Inc. [to PacWest Bancorp] and Taylor Capital Group Inc. [to MB Financial Inc.]. In both cases,” the analysts said, the sellers “lacked efficient funding to sustain their current growth rates and decided to explore strategic alternatives with better-funded institutions.”

While noting that predicting takeout targets is always challenging, the analysts cited Macatawa Bank Corp., Old Second Bancorp Inc. and Territorial Bancorp Inc. as potential targets in their coverage universe of some 200 small- to mid-cap banking companies “as all three have solid core deposit bases with excess lending capacity.”

Potential buyers focused on enhanced funding, from the Keefe Bruyette & Woods analysts’ view, include BankUnited Inc., BNC Bancorp, IBERIABANK Corp., Independent Bank Group Inc., Fidelity Southern Corp., Renasant Corp. and PrivateBancorp Inc.

A heightened focus on deposits likely will continue to push up the value of deals, too, Perito told SNL. Aggregate disclosed deal value of \$18.6 billion last year was up from \$14.2 billion in 2013, according to SNL data.

Appealing areas of the country include Pennsylvania, Florida and Greater Chicago — in part because they are heavily populated but also heavily banked markets, Perito said. Just this week, Chicago-based Wintrust Bank, a unit of Wintrust Financial Corp., agreed to buy fellow Windy City lender North Bank.

Perito noted that plenty of buyers have studied Texas, too, and that could continue, though he said there is currently a sense of caution about getting into the Lone Star State, given its energy industry foundation and the plunge in oil prices since last summer.

Perito said that, in addition to possible funding challenges, many small banks continue to struggle with heavy regulatory burdens and the current low-rate environment. As a result, he anticipates the bulk of M&A activity this year will be among small community banks, as it has been for several years.

But he noted a few important larger deals, the successful closing of which could encourage more M&A on the big-bank front. Perito said the timely closing of BB&T Corp.’s planned buyout of Susquehanna Bancshares Inc. (\$18.66 billion in assets) and Royal Bank of Canada’s deal to acquire City National Corp. (\$32.61 billion in assets)

would show that larger deals can get done without hairy regulatory issues slowing things down and driving up costs, as has been the case for M&T Bank Corp.'s deal to buy Hudson City Bancorp Inc. The latter deal has been on hold for more than two years because of regulators' Bank Secrecy Act and anti-money laundering compliance concerns, Perito noted.

The analyst anticipates that both BB&T and Royal Bank of Canada will close their deals in the second half of this year and that, as the companies have indicated, M&T will finally put the wraps on its acquisition of Hudson City before the end of the second quarter.

If these developments unfold as he anticipates, Perito said it could not only encourage BB&T and Royal Bank of Canada to pursue other sizable deals, but could also motivate other large banks — including Bank of Montreal, Huntington Bancshares Inc. and U.S. Bancorp — to consider bank acquisitions.

"It would show that it is plausible to accomplish a deal of size," Perito said. And that, he added, would bode well for 2016 bank M&A. *i*