

EUROMONEY

M&A: Why so quiet?

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US bank consolidation is hanging fire; Will private equity firms jumpstart the market?

Given the dire state of the US banking industry through 2008 and 2009 so far, just why there has been so little M&A activity is a pertinent question. The number of US banking and thrift mergers and acquisitions dropped by more than half to 126 last year, and only totalled 52 up to June 19 this year.

To some extent, the US government's Tarp programme is being held responsible. Richard Davis, chief executive of US Bancorp, says: "For those who took Tarp money, even without passing the stress test, there was enough capital to continue business. That backstop by the government meant that some banks were not thrown into the arms of others. While I am supportive of the government's intentions with the programmes, the unintended consequence was a slowing in M&A activity. I think in the near term, every bank will still be around six months from now as a result."

Davis's firm accepted Tarp money but subsequently paid it back. He says his firm might consider small pure banking acquisitions.

No burns

Elizabeth Nesvold, founder of M&A advisory firm Silver Lane Advisors, says Tarp only goes some way to explain the quiet spell.

"There has just been so much uncertainty, particularly over December to February, that there was a hesitancy," she says. "Banks were not functioning normally during that period. Who would want to put their neck on the line to do a deal, with a reasonable probability of getting burnt by unpredictable markets."

Nesvold says the pipeline of deals is there but the environment is making it harder to get them done.

"Every deal takes three times the effort and a lot of patience in the highly regulated environment we are in," she says. "With the weaker banks there is more review than ever to make sure acquisitions will stabilize the institution being acquired and be good for the shareholders of the acquirer."

Derek Ferber, M&A analyst at SNL Financial, believes there is still too much uncertainty. "Instead of focusing on expanding, banks are looking critically at their capital levels and loan-loss reserves. The other issue is supply and demand. With less demand for banks and thrift transactions, we are continuing to see very low valuations."

Where banking M&A might pick up in the second half of the year is through private equity interest. At the end of May, a consortium led by Blackstone acquired BankUnited, a failed Florida-based bank that had been taken over by the Federal Deposit Insurance Corporation. Through an auction by the regulators, Blackstone took a share in \$10.7 billion of the bank's \$12.8 billion in assets, with the government taking 80% of the first \$4 billion in losses and 95% of any remaining losses.

"We are bringing in a great new management team to build a strategically valuable banking franchise in a region where the competition has been decimated. It is an example of how private equity firms like [us] are providing capital to help get the economy moving at a critical juncture," says Tony James, COO and president of Blackstone Group.

Cut risk

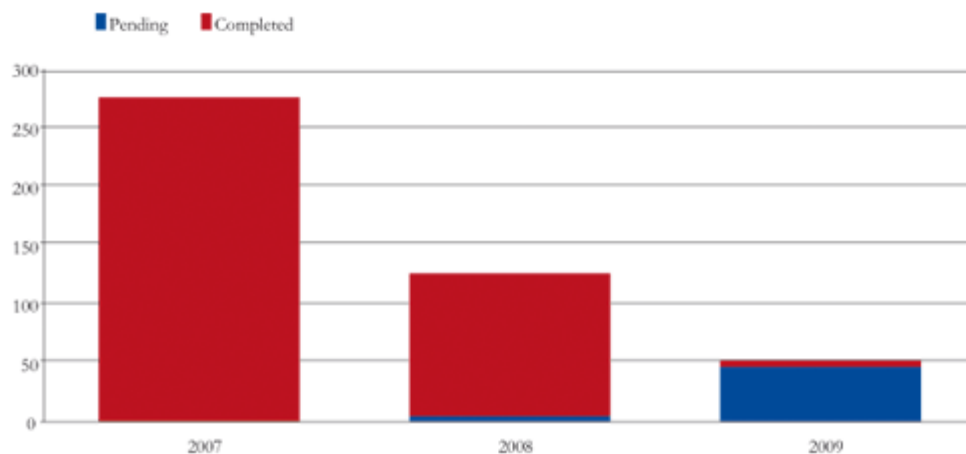
Ferber believes it is a template for things to come. "When it comes to distressed situations, private equity firms are on the prowl. If they can negotiate a loss-sharing situation with the government, as with the BankUnited deal, that cuts out a lot of risk and makes it a more attractive proposition."

Number of bank and thrift merger and acquisition deals

From 2007 to June 19 2009

"We're off average number deals by about 60% this year, and so far we have only seen brave souls doing deals in the eye of the storm"

Elizabeth Nesvold, Silver Lane Advisors



Source: SNL Financial

Nesvold agrees that there is likely to be more private equity or hedge fund interest in acquiring banks. However, she also believes that there will be generally more activity in the second half of the year.

"We're off average number deals by about 60% this year, and so far we have only seen brave souls doing deals in the eye of the storm. We may not return to the peak but we will certainly have a better year than the first half would suggest.

"In the end it comes down to size. As deals take place, acquiring firms move up the ladder and competitors move down. That generally encourages M&A activity."

Nesvold, however, believes that there will be more intra-industry activity across financial sectors, rather than pure capital infusions. "We'll likely see everything under the sun – bank-to-bank deals and transformational asset management combinations like Blackrock and BGI. I don't suppose there will be many mega deals such as that, but there are some incredible opportunities out there for the strong-hearted."

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