Deloitte M&A Views podcast:
Banking on M&A: Trends impacting deal activity

Transcript

Greg: Welcome to Deloitte M&A views, a Deloitte podcast series exploring the latest trends and topics in mergers and acquisitions (M&A). I'm Greg Jarrett, and today we tackle part one of a two-part series discussing the current M&A deal environment in the banking industry. We're joined by two members of the Deloitte banking M&A leadership team, Paul Legere, principal with Deloitte Consulting LLP, and Jay Langan, partner with Deloitte & Touche LLP.

Greg: Gentlemen, first of all, thanks for taking the time to be with us today. Paul, why don't we start with you for a quick overview of M&A activity in the banking industry. Not just for this past year but perhaps even going further back. What did that look like?

Paul: Well, thanks, Greg. And if you look over the last few years, we've seen some choppiness in the markets. Deal volume, broadly, is coming down a little bit. It was 249 announced deals in 2016 for the 12 months, down a bit from '15. And this year's looking like it's probably going to come down a little bit more in number. However, this is where it gets interesting: Deal value overall is up. And I think that's indicative of what we're seeing in the marketplace, which is the larger institutions are beginning to pick where their spots are, where they can actually make money in this new market, the new environment, the new interest rates, the new margins. And they're doubling down there. And in those areas, they're going to be going out and making some deals. So that's one of the reasons why we're seeing, I think, some of the uptick in deal value as well as some of the slightly smaller volumes.

Greg: I had a look at the banking M&A outlook that Deloitte released at the beginning of the year, and it suggested that after the three years of robust activity like you just mentioned, Paul, that banking and securities organizations may be taking a short pause in early 2017 before resuming M&A activity. That's spot on as far as I can see. Jay, what do you think could be a couple of drivers or influences of these deal trends?

Jay: In the economic environment we're living with today, I think there are five influences of activity—and Paul and I will talk about them in a little more detail. But as we meet with clients, we're hearing that quite frequently. I think the first I'd want to touch on is the impact of the post-election regulatory policy shifts. I think when we wrote our piece we were a little uncertain, and we stay there. I think there's been some noise of late in terms of some acts in Congress, but I think we're going to have a long road to hoe before we get some finality on what's going on

there. But I think that's caused some of our pause, but I think as things build up a touch—I mean, we've seen some deals' size increase—we expect it to pick up in the second half of the year.

Next is going to be rates. Given how rates are motherhood and apple pie to banks when they rise, we've had a couple rate increases since we put our piece together. You know, there's anticipation of another increase coming around the corner. Those are positive signs. I don't think they're a panacea quite yet, but a continued slow movement of rates upwards helps banks and interest margins. And it helps their profitability, which makes more banks desirable targets and gives banks whose stock appreciated more drive to do deals. So I think that's terrific news as rates continue to rise.

And I think the third piece, which I was personally probably a little bit more excited about as we pulled our piece together, was the potential for tax reform. There is a lot of opportunity should their reform get done in terms of war chests for investments as firms repatriate cash. We're seeing a little bit of cessation of activity there in terms of odds of getting something done in the short term. I think it will be quite interesting for the mortgage business if things get done as we talked about it in terms of interest deductions, deductions of Cap-X being expedited, so there's a couple of interesting things there we can keep our eyes on. But for now, it's still something that's kind of an uncertain outcome.

Greg: Paul, Jay has talked about not only the political aspect of what's happening with banking M&A and regulations, but also as far as interest rates and that impact is concerned. Would you address this for us as well?

Paul: Sure. I think a lot of times we get hung up a bit on interest rates and just how big a deal they're going to be in terms of M&A activity. I think the logic would dictate that if interest rates and margins ultimately rise roughly in parallel or in sync with each other, there could be an increase in lending and other activities that are going to take advantage of those interest rates' rise. However, and this is a big however, they don't go up in unison. They don't go up at the same time. There is usually a lag because the way lending gets funded is through deposits—and deposits also can be mobile. They can go in, they can go out. They can go up, they can go down. So, I think while the interest-rate environment does look like it's going to improve—go up for the banks—that's just one factor among a sea of factors. And I think we have to consider it that way.

Greg: So, Jay, if we're taking advantage of opportunities amid these times of what so many people across the globe are calling "uncertainty," what should banks really consider doing now?

Jay: Well, I think the first thing, and we're seeing a lot of our clients responding accordingly, is dust off their playbooks. You know, it's been quite a while since many banks have done deals—they've been on the sidelines. I would say that in the interim, the cadence and pace of deal activity slows with a much keener eye on regulatory approval. I think sellers and buyers understand that it takes a lot longer to do the dance. And folks who don't invest fully, it almost is a negative red flag of seriousness with deals. So, we're encouraging folks to do a lot more diligence to both their stakeholders—as, you know, shareholders—but also stakeholders in terms of regulators and bodies that have a stated interest in the success or lack of success in a future enterprise. So I think folks are really dusting things off and changing their pace of deal to make sure they can properly get a deal done in this environment.

I think another thing that we are focusing on is the definition of what a deal is today. I think we will continue to see a ramp up of your classic depository institution, buying depository institution, but we're seeing clients—especially given where loan origination volumes are. But the joint ventures(JV), strategic alliances,

you know, irregular ways of going about doing deals. And they're requiring a lot more help, given the unique structure and legal requirements associated, but I think that's an area where we're seeing continued activity, especially in the fintech space. So we're very excited about those things.

The market conditions continue to accelerate from an M&A perspective. Looking back since the crisis, which is probably the most optimistic view about deals getting done, so I think there's a lot of positive energy going on. It's translated a little bit in the first half of the year in terms of deal size up. But I think we'll see more to come.

Greg: As we wrap up this discussion, Paul, can you share with me one closing thought around the next six months and what that looks like for M&A in the banking industry?

Paul: Sure, Greg. I do see us getting closer to the next wave of M&A, so to speak. But I don't know that I see a marque event on the immediate horizon. A lot of talk about regulatory reform, or big tax cuts, or the potential for some large infrastructure, all of which plays to banks and financial services lending, etc. However, I think with all of the different items in flux right now in Washington and the noise that's emanated not only from Washington, but geopolitically, as we're far more connected these days, I don't know that there's any one thing that any institutions are kind of banking on at this point. So, if I were looking at the next months, I guess I'd look at this and recognize that we've come a long way since the downturn. I think the immediacy of the correction that banks have taken, either pro or con, selling or buying, have basically stabilized, as have a lot of the lower cost structures out there which is why earnings have looked so good. So I think that there are good opportunities in the marketplace and I do expect—I think we do expect broadly—that M&A activity as a result will be picking up as banks continue to look forward in the transforming landscape in which they're playing.

Greg: Jay, is there a central theme, something that maybe people could wrap their arms around and say, "This is going to be something to keep an eye on for 2017"?

Jay: Sure, and I think it's actually happened. And that's the Fed raising their review threshold from deals of $25 billion combined assets to up to 100 billion dollars. That clears the way for a lot of deal activity. So, I viewed that as a very positive step. And, you know, we've seen that in the deal side as doubling year over year encouraging that. I think smaller community players might see their deal volumes continue to slow—they've been the driver of deal volumes the last couple of years. I think it's a little bit of engine running dry in terms of drive power of activity there. I think the sweet spot going forward over the next 12 months is banks that are caught in a little bit of limbo—north of $10 billion in assets, south of $100 billion. And I think we will see players rise from that, those ranks to rise up and go from a regional player to a super-regional player. So I think that's going to be the theme we see going forward in terms of where the major deal activity happens in the next 12 months.

So, my last comment I would say is for folks who are viewing their stock appreciation disproportionately, whether it's due to interest rate planning challenges or business model issues, take a closer look at what you're doing in terms of an operating model. And, again, doing M&A is a possible strategy to resolve that. I think folks have been on the sidelines, hesitant to pull the trigger. I think this is going to be a very robust opportunity as bid-ask spreads combine and shrink for you take advantage of the rising in tide.

Greg: I'm Greg Jarrett. Thanks for listening to Deloitte M&A Views, sponsored by Deloitte's M&A Institute. For more information around insurance M&A, download the latest report at www.deloitte.com/us/insurance-ma-outlook. We also release new podcasts regularly, and if you subscribe, you won't miss a single one. To stay connected and

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