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Less is More

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Bank Buyers & Sellers Simultaneously Create Shareholder Value

- **Effective Sale Price is Increasingly Enhanced by EPS Accretion in Recent M&A**
- **Transaction Pricing Discipline Drives Higher Value for Sellers**
- **Sellers: Know When to Stop Pushing for the Marginal Dollar**
- **Buyers: Articulate EPS Accretion Realistically**
- **Investors: Encourage Buyers & Sellers Accordingly**

A banking consolidation cycle is again underway. **Unlike past cycles, many recent acquisition transactions contain powerful earnings accretion to be realized by the buyer**. This dramatically changes the seller's prospective value realization calculus if any significant portion of the purchase is accomplished with stock.

A bank contemplating or structuring a sale is making two important decisions at the same time: Their most important sell decision and their most important buy decision. Investor and bank managements and their boards should increasingly recognize the latter when negotiating terms. It is axiomatic that selling your bank for stock is essentially investing in the acquiring bank's stock.

Historically, bank M&A transactions gave the buyer an opportunity to increase earnings per share through moderate accretion. These were typically low-single-digit percentages for the buyer's pro-forma EPS which typically were achieved over the course of many years. Many of the pro-forma accretion objectives today are massively higher than they were historically, often in solid double-digits achievable in much shorter time frames.

Assuming fixed exchange ratios for stock transactions, this accretion can be quickly reflected in the market value of the buyer's stock. Hence, when a seller negotiates for the highest price calculated on the basis of buyer's pre-announcement stock price, realized upside in the ultimate sale can quickly face diminishing and often negative returns.

The seller obviously inherits some of the buyer's price discipline. Pushing for the additional dollar can readily thwart final transaction value.

There is a natural "tug-of-war" between earnings accretion and book value dilution. Until recently investors have been more focused on the latter, but in two prominent deals the buyer's stock price has soared more in reflection of earnings than book impact. This also reflects a steady valuation metric shift from price-to-book to price-to-earnings as we leave the financial crisis mentality and bank earnings recover and begin growing.

Of course, book dilution is still important, but no longer solely defines post-announcement stock price reaction. Earnings impact is gaining recognition and has been an effective counterbalance. In a half dozen recent bank mergers, mean tangible book dilution was 7% but pro forma mean earnings accretion in the first year was solidly in double digits, reducing the earn-back period below three years.

Mean stock price performance for ***buyers***, relative to the S&P Bank Index for these transactions, was a remarkable 7% rise a week following the market price prior to announcement! Two of them produced 12% and 25% outperformance respectively.

The mean premium at announcement for this group was still 20%. We strongly suggest that had the sellers sought a higher "sticker-price" the subsequently diminished earnings accretion would have also hampered the buyer's stock price performance and would therefore have resulted in a lower effective value realization for the seller than was the case with less dramatic premiums to market. In this analysis, less is clearly more.

Investors historically greeted consolidation cycles by investing in banks thought likely to successfully sell. This was always diluted by holding a portfolio of names that included those failing to attract persuasive bids and/or limited receptivity for sale. Buyers almost always expected and faced initial price declines as acceptable cost for longer term strategic positioning and building value.

This pattern is now reversing. In addition, both size and capital access are increasingly critical. **The M&A value proposition is now swinging in favor of disciplined buyers as well as sellers**. This discipline should be expected and respected by sellers as they consider both transaction structure and pricing, as it has the potential to meaningfully increase value received.

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