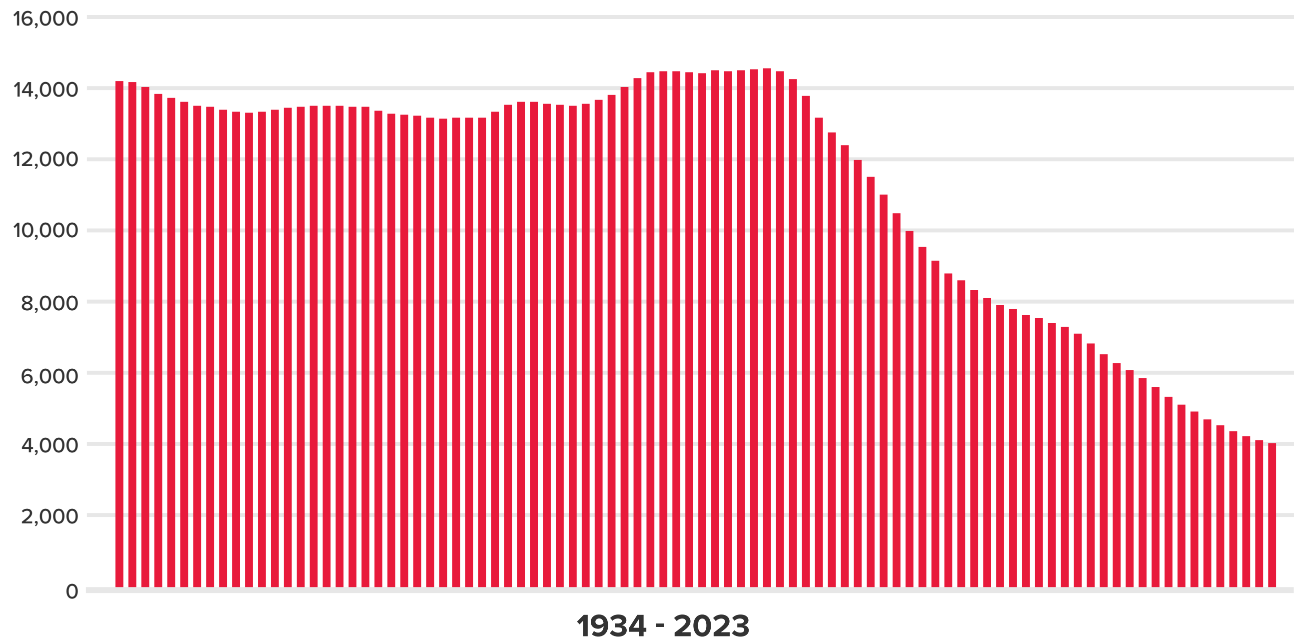
Five Factors Buyers Consider in a Bank Acquisition

BDO

Financial institutions are planning for a [rebound in mergers and acquisitions] (M&A) activity and identifying opportunities for growth in 2025. Consolidation in the banking industry is a trend that is expected to continue, as indicated by the decreasing number of banks in the United States due to bank M&As:

Number of Banks in the USA 1934-2023



Source: FDIC

When analyzing the decrease in the number of banks on a state-by-state basis from 2018 to 2023, Illinois (45), Missouri (37), Iowa (33), Minnesota (27), and California (24) experienced the largest declines. As more institutions look to acquire other banks to help advance their growth strategies, it is critical they thoroughly assess the viability of their targets.

Acquirers weigh numerous factors when considering a bank acquisition. Chief among them are their target's metrics, ownership interests, cost considerations for growth, market factors, and risk and compliance complexity.

By understanding what potential buyers look for and where they are likely to look, banks planning an exit can strategically position themselves for acquisition.

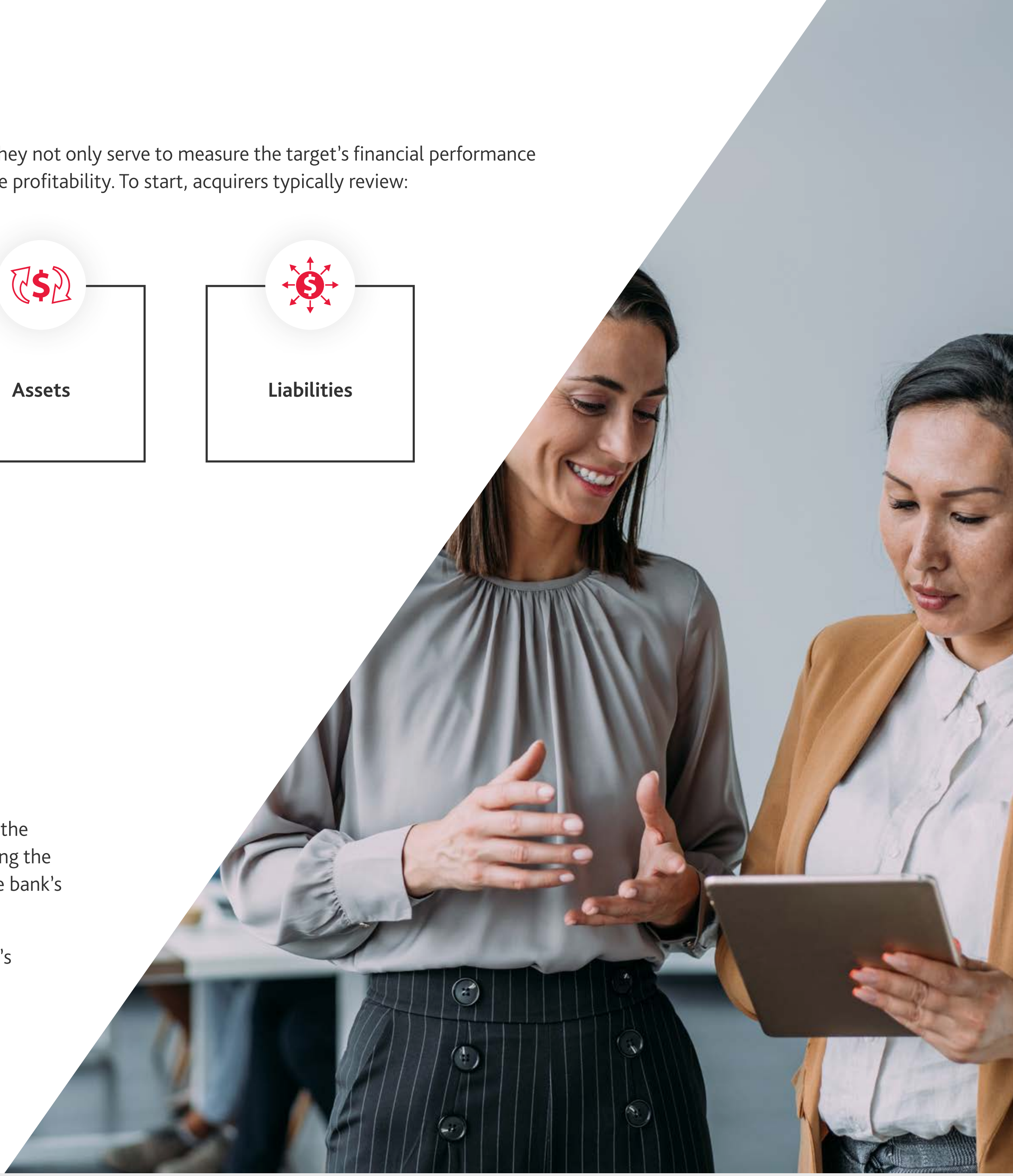
METRICS

When a buyer considers a bank acquisition, metrics play a critical role. They not only serve to measure the target's financial performance over time, but can also help an acquirer determine its potential for future profitability. To start, acquirers typically review:

- Income Statement
- Credit
- Assets
- Liabilities
- Equity
- Cost-to-Income Ratio

Acquirers also review a target's credit reserves to see how it measures **credit risk**, as well as its historical loan loss data. The quality and age of the **bank's loan portfolio** can be a particularly strong indicator for forecasting the bank's performance as it helps reveal default risk based on the size of the bank's loans, its borrowers, and the risk level of the loans, among other factors.

By assessing these factors, acquirers gain a stronger sense of their target's overall health and viability for acquisition.



OWNERSHIP INTERESTS

When an institution considers an acquisition target, it understands that the deal extends beyond buying the bank: It is also acquiring ownership of its institutional knowledge and stewardship.
A bank's executive leadership team, namely its CEO, can significantly influence its attractiveness to a prospective buyer. For instance, if the CEO of the acquiree target has a proven track record of **strong business performance**, an acquirer might deem that target more trustworthy than other institutions that don't.

Beyond the balance sheet, buyers view acquisitions as opportunities to build upon their broader base strategy and will want to ensure visionary alignment with their target. To grasp a target's visionary alignment, acquirers carefully consider its shareholders — specifically its ownership concentration distribution — and their priorities. Buyers may ask potential sellers questions to gauge their appetite for a monetization event of the ownership interest, as well as their desire to continue carrying the legacy of the bank.

Understanding a potential acquiree's ownership interests and leadership dynamics enables acquirers to gain a better sense of the bank's trajectory and its ability to steer it.

COST CONSIDERATIONS FOR GROWTH

Once a potential buyer assesses a target's financial performance and ownership interests, they weigh cost considerations for growth. To understand an acquiree's growth potential, many acquirers evaluate their target's deposit base, including its deposit composition, customer concentration, and deposit growth rate.

Banks with more diversified deposit composition and lower customer concentration, for instance, tend to be more attractive targets to potential buyers seeking long-term stability. Acquirers also assess the growth rate of the bank's deposits to gauge access to liquidity. A higher deposit growth rate might also indicate greater customer retention and acquisition, enhancing the bank's overall appeal to a potential buyer.

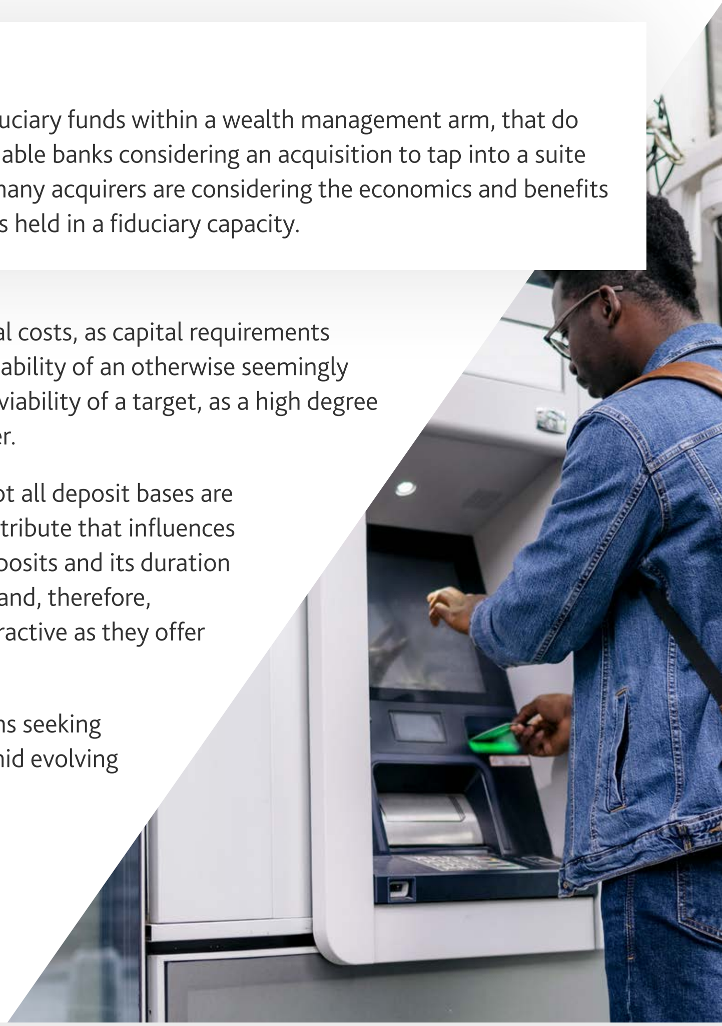
The Appeal of Trust Assets

More buyers are eyeing a target's trust assets, such as fiduciary funds within a wealth management arm, that do not typically appear on the balance sheet. Trust assets enable banks considering an acquisition to tap into a suite of wealth management services and assets. As a result, many acquirers are considering the economics and benefits of the float they would earn on the fees from those assets held in a fiduciary capacity.

Acquirers measure these factors against a target's operational costs, as capital requirements and integration costs can significantly impact the financial viability of an otherwise seemingly attractive acquiree. Similarly, debt ratio can also impact the viability of a target, as a high degree of outstanding debt is likely to shrink margins for the acquirer.

While some target acquirees may pass these benchmarks, not all deposit bases are considered equally valuable. Deposit stickiness is a critical attribute that influences the attractiveness of a bank target. A bank's certificate of deposits and its duration are strong indicators of the predictability of its deposit base and, therefore, stickiness. Escrow accounts, for example, are particularly attractive as they offer institutions a stable deposit base.

Although scalability potential is a critical factor to institutions seeking a bank acquisition, stability remains a chief consideration amid evolving macroeconomic conditions.



RISK AND COMPLIANCE COMPLEXITY

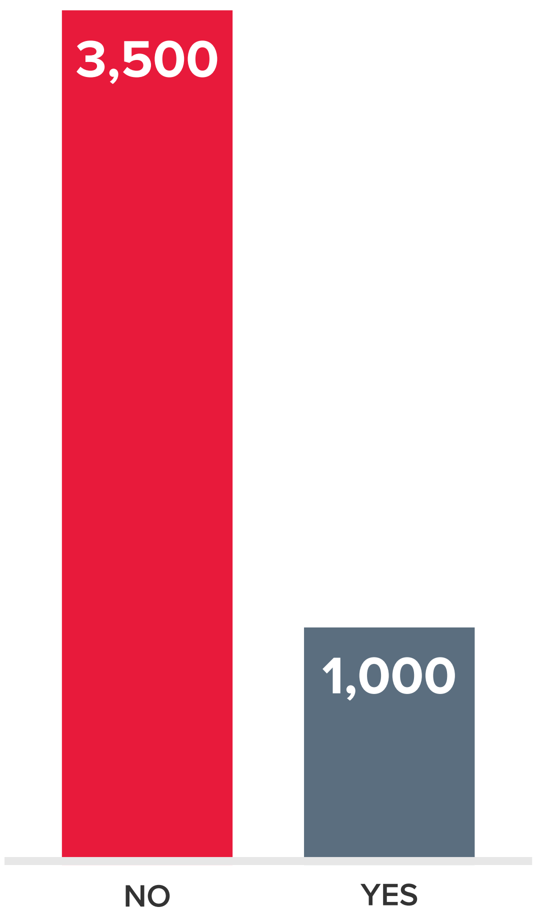
Buyers recognize that an acquisition will lead to scrutiny of the target's financial health, regulatory compliance, and internal controls and processes for financial reporting. For example, the Internal Control Over Financial Reporting (ICFR) remains critical to protecting the integrity of a company's financial reporting and mitigating financial statement risk. Many also expect regulatory scrutiny of dealmaking to intensify following the Office of the Comptroller of the Currency (OCC)'s final rule updating its Bank Merger Act. The updated guidelines, which took effect January 1, 2025, removed provisions related to expedited review of banking M&A in a move to improve M&A transparency and give the OCC the time it needs to thoroughly vet potential bank deals.

As a result of intensifying oversight, buyers will want targets to meet the regulatory requirements that they know the OCC and other regulators are looking for ahead of dealmaking. To increase chances of deal approval, buyers must remain vigilant of antitrust issues, as well as their target's compliance history and more.

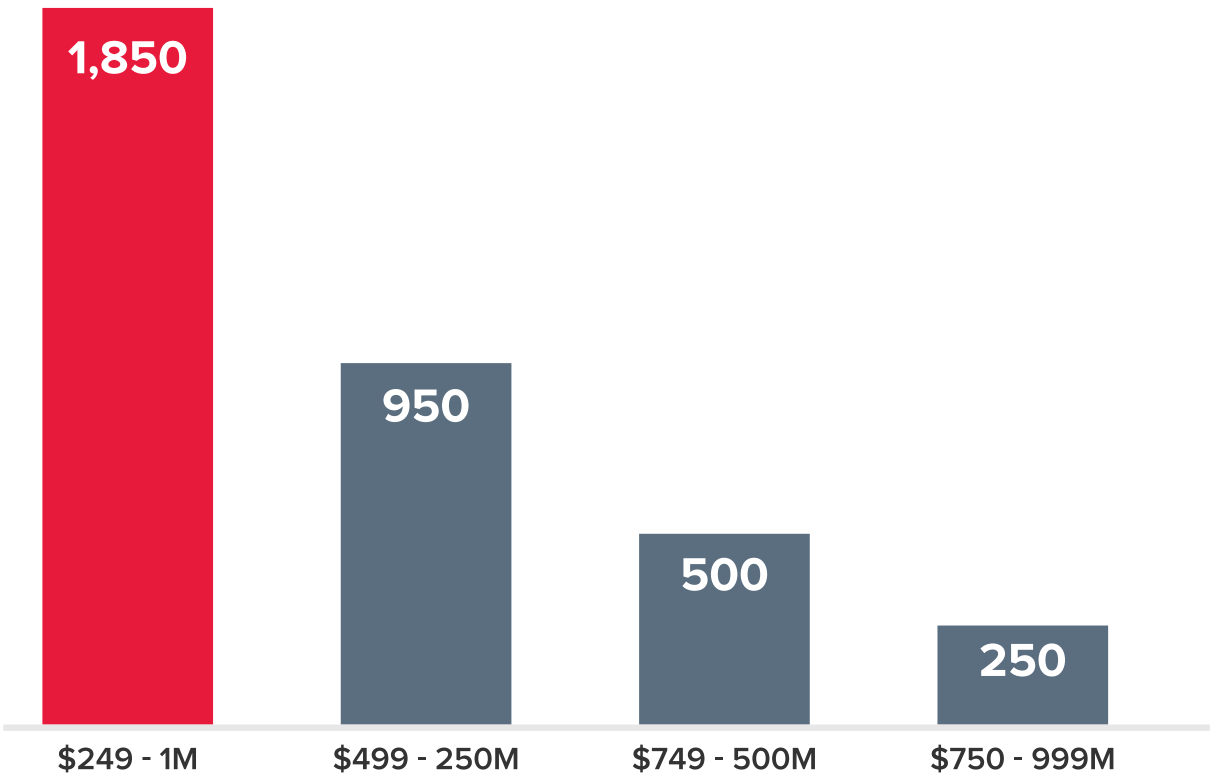
In anticipation of other new and emerging guidance, acquirers are likely to closely assess a target's existing regulatory obligations, as well as internal controls and reporting processes, to mitigate the risk of non-compliance. Acquirers will also want to determine what risk and compliance factors need attention, if any, and what they need to do to be able to comply or uphold the acquiree's regulatory requirements:

- **Industry Concentration:** Are the target's customers heavily concentrated within a specific industry? Higher concentration could potentially lead to more risk for acquirers.
- **Geographic Presence:** Acquirers want to know where their target's banks are located and the number of branches they have. They also assess the economic growth and geopolitical stability of the locations in which the target operates.
- **Regulatory Frameworks:** Local, federal, and international regulations carry unique risk implications. In the U.S., state regulators have different reputations in the marketplace, with certain states exercising more vigilance in their regulation of banks. Potential acquirers examine the regulatory frameworks under which the target bank is operating to understand the degree of complexity for maintaining compliance.
- **Financial Milestones:** Given their deposit growth and high inflation, an increasing number of regional banks are approaching the billion-dollar mark. When banks hit this threshold, there is an added layer of cost from a compliance perspective. A target bank can be highly attractive from a profitability standpoint, but an acquirer might realize that the risk and compliance factors outweigh the potential cost benefits.

Financial Institutions With Assets Greater Than $1B at 6/30/2024



Banks Under $1B Total Asset Range



Source: FDIC

Of the roughly 3,500 banks that are under $1 billion, approximately 270 of them are in the $750-999 million range of total assets. As these banks cross over the $1 billion threshold, the cost of compliance from enhanced financial reporting requirements and regulatory oversight become significant considerations for a bank's growth strategy.

MARKET FACTORS AND FUNDAMENTALS

Many banks looking for an acquisition aim to spread from their comfort base, knowing their clients and the demographics to which they are lending. When a buyer vets a target acquiree, it seeks to understand the target's offerings at a deep level to assess how the deal can help expand their market reach.

Geographic presence is a primary market factor. Is the region in which the target is operating experiencing strong economic growth, or stagnancy? Potential buyers also evaluate their target's customer segments and the makeup of the target's **loan portfolio**. If a market starts to saturate, for example, the valuation of the target might be lower and therefore less inviting to the acquirer.

Assessing these fundamentals ultimately helps a buyer understand the competitive position of its acquiree target and any possibilities for expansion.

How BDO Can Help

As the likelihood of consolidation within the banking industry grows, buyers will exercise increased discernment of their targets and understand how they serve the institution's broader base strategies. On the other hand, banks looking to be acquired can prime themselves for a deal by understanding the needs of their buyers.

Acquisition vetting can be a long and complex process, and banks need many resources to prepare for M&A. BDO helps clients throughout the acquisition journey, from portfolio analysis and screening acquirees to valuation and more.

INTERESTED IN EXPLORING ACQUISITION OPPORTUNITIES?
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