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BUSINESS VALUATION &
FINANCIAL ADVISORY SERVICES

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Bank Watch

ARTICLE

Low Rates and Tighter NIMs Spur Bank Interest In the Wealth Management Sector

In This Issue

Low Rates and Tighter NIMs Spur Bank Interest In the Wealth Management Sector

COVID-19 adversely affected RIA M&A for a couple of months when most of the U.S. was under shelter at home/safer in place orders. However, deal activity is recovering quickly and now could be further accelerated as banks look to replace lost interest income with fee-based revenue. An increasing number of clients on the banking side of our practice are showing interest in the wealth management space, and it's easy to understand why. Interest rates hovering at historic lows have significantly impaired net interest margins, so banks are exploring other income sources to fill the void. Wealth management is a natural place to start since so many banks already offer financial advisory services of one form or another.

There are many other reasons why banks have wealth managers on their radar:

- Exposure to fee income that is uncorrelated to interest rates
- Minimal capital requirements to grow assets under management
- Higher margins and ROEs relative to traditional banking activities
- Greater degree of operating leverage – gains in profitability with management fees
- Largely recurring revenue with monthly or quarterly billing cycles
- Sticky client base
- Access to HNW/UHNW client base and opportunity to increase wallet share
- Potential for cross-selling opportunities with bank's existing trust and wealth management clients

These incentives have always been there, but COVID amplified the banking industry's need to diversify their revenue base, and RIA acquisitions are almost always immediately accretive to earnings at the cost of dilution to tangible book value. The shape of the current yield curve suggests that long-term rates are likely to stay below historic norms for quite some time, dampening the outlook for bank interest income. Acquiring an RIA or bulking up an existing wealth management practice with experienced advisors is a relatively easy way to pick up non-interest income and improve profitability. Building-up non-interest income is also an effective hedge against a further downturn or future recessions that might require the Federal Reserve to lower rates even further.

Still, there are several often overlooked deal considerations that banks and other interested parties should be apprised of prior to purchasing a wealth management firm. We've outlined our top four considerations when purchasing RIAs in today's environment:

1. With most of the domestic equity markets back to near-peak levels, the financial commitment required to purchase a wealth management firm has likely increased in recent months, lowering the prospective ROI of an acquisition. We often see some temptation to pay a higher earnings multiple based on rule-of-thumb activity metrics (% of AUM or revenue), but we would typically advise against paying above normal multiples of ongoing EBITDA for a closely held RIA, absent significant synergies or growth prospects for the target company.

2. Since many wealth management firms are heavily dependent upon a few staff members for key client relationships, many deals are structured with earn-outs to ensure business continuity following the transaction. These deals tend to take place over two to three years with a third to half of the total consideration paid out in the form of an earn-out based on future growth and client retention. COVID-19's impact on the markets and economy has elevated the demand for buyer protection, and many banks are now requiring larger earn-out components to protect themselves from future downturns or client attrition.

3. It's hard to know how the cultures of firms in any industry will mesh after a merger, and this side of due diligence has been most affected by COVID-19, as in-person meetings are still generally being avoided. The culture issue is especially true for bank acquisitions of wealth management firms. Compensation, work habits, client service expectations, and production goals can be drastically different at an RIA versus a bank, so it's important to consider if these discrepancies could become problematic when the firms join forces. We've seen culture clashes blow up deals that looked great on paper.

4. Degree of Operational Autonomy. Wealth managers (and their clients) value independence. Individual investors typically must consent to any significant change in ownership to retain their business following a transaction and may not be willing to do so if they feel that their advisor's independence is compromised. Senior managers at the target firm will likely need to be assured that the new owner will exert minimal interference on operations and strategic initiatives if key personnel are to be retained.

These considerations manifest the need for an outside advisor to ensure that proper diligence is performed and the transaction makes sense from an economic perspective. Bank boards need practical guidance on finding the right RIA at the right price and assessing cultural differences that could wreck the integration after the ink dries. As always, we're here to help.

Brooks Hamner

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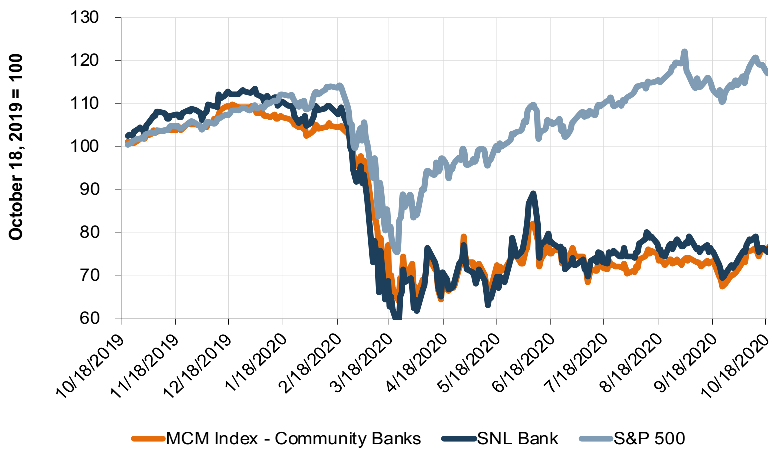
What We're Reading

Congress recently introduced a new bill that would let smaller banks (assets under $15 billion) exclude PPP loans for the purposes of determining capital ratios and other asset thresholds. Additionally, the SBA **eased the forgiveness process for smaller PPP loans** and issued guidance on changes in ownership of PPP

Amongst a scarce year for bank M&A, **First Citizens BancShares and CIT Group announced an all-stock merger** (roughly valued at $2.2 billion) that would create a **$100 billion asset bank** and rank as one of the 20 largest institutions in the country.

As personal income and spending recovers from the COVID-19 contraction, gaps in the data are starting to emerge with the roll-off of widespread government support.

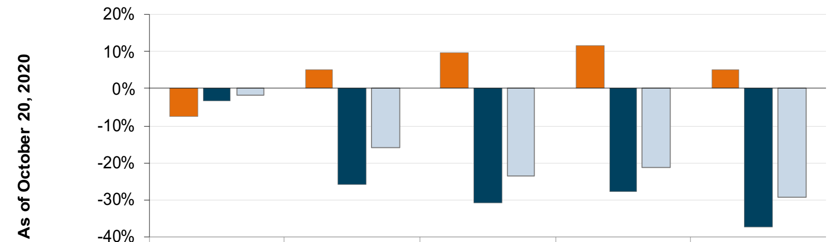
Mercer Capital's Bank Group Index Overview



Source: S&P Global Market Intelligence

Return Stratification of U.S. Banks

by Asset Size



	Assets $250 - $500M	Assets $500M - $1B	Assets $1 - $5B	Assets $5 - $10B	Assets > $10B
Month-to-Date	-7.59%	5.08%	9.72%	11.80%	5.26%
Year-to-Date	-3.07%	-25.97%	-30.58%	-27.64%	-37.17%
Last 12 Months	-1.69%	-16.00%	-23.56%	-21.12%	-29.10%

Source: S&P Global Market Intelligence

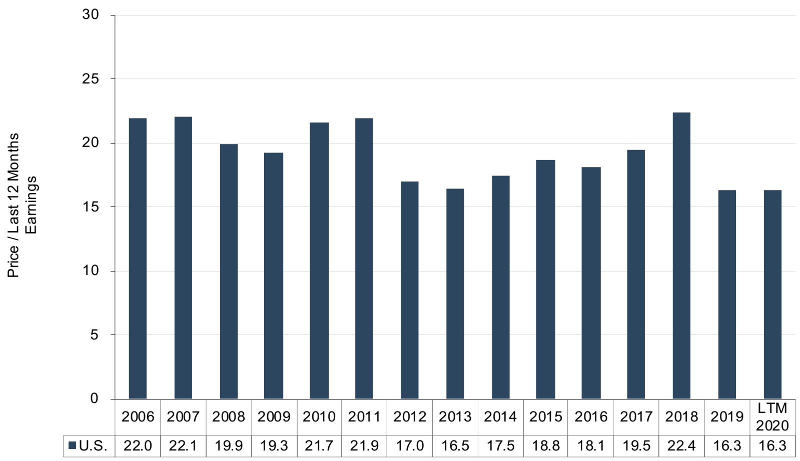
Median Valuation Multiples

	Median Total Return			Median Valuation Multiples as of October 20, 2020					
	Month-to-Date	Year-to-Date	Last 12 Months	Price/LTM EPS	Price / 2020 (E) EPS	Price / 2021 (E) EPS	Price / Book Value	Price / Tangible Book Value	Dividend Yield
Atlantic Coast Index	8.1%	-35.7%	-30.8%	9.1x	12.1x	11.9x	77%	84%	4.0%
Midwest Index	8.8%	-24.8%	-16.6%	9.4x	10.2x	11.5x	87%	99%	3.1%
Northeast Index	8.8%	-32.7%	-26.7%	10.0x	10.1x	10.1x	75%	90%	3.8%
Southeast Index	7.9%	-28.2%	-20.9%	11.7x	11.5x	11.3x	85%	94%	2.5%
West Index	11.7%	-28.1%	-21.3%	9.6x	9.8x	10.7x	85%	96%	3.0%
Community Bank Index	9.0%	-29.9%	-23.3%	9.8x	10.4x	11.2x	83%	91%	3.4%
SNL Bank Index	**5.5%**	**-32.0%**	**-23.4%**						

Source: S&P Global Market Intelligence

Median Price/Earnings Multiples

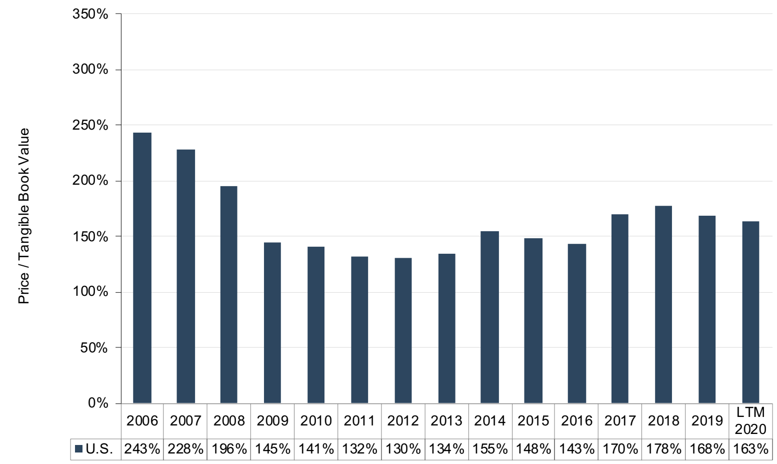
Target Banks' Assets <$5B and LTM ROE >5%



Source: S&P Global Market Intelligence

Median Price/Tangible Book Value Multiples

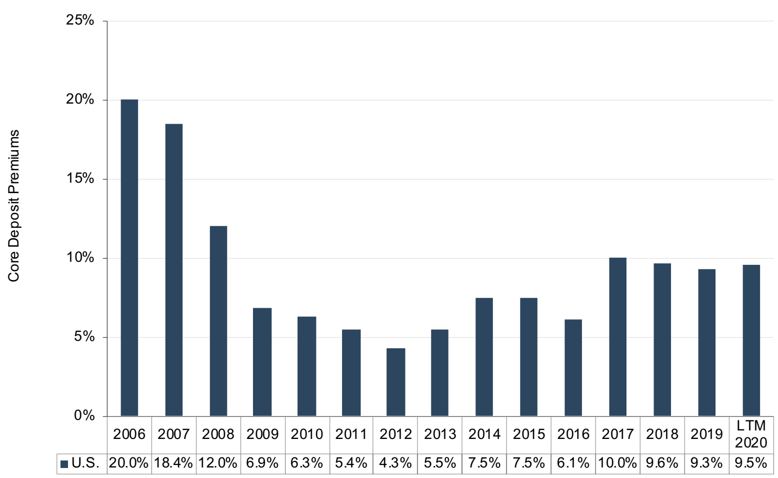
Target Banks' Assets <$5B and LTM ROE >5%



Source: S&P Global Market Intelligence

Median Core Deposit Multiples

Target Banks' Assets <$5B and LTM ROE >5%



Source: S&P Global Market Intelligence

Median Valuation Multiples for M&A Deals

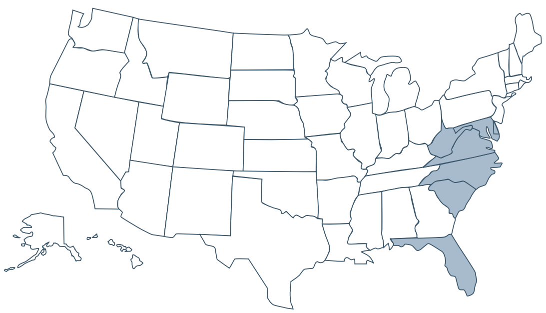
Target Banks' Assets <$5B and LTM ROE >5%, 12 months ended October 26, 2020

Regions	Price / LTM Earnings	Price/ Tang. BV	Price / Core Dep Premium	No. of Deals	Median Deal Value ($M)	Target's Median Assets ($000)	Target's Median LTM ROAE
Atlantic Coast	14.4x	102%	6.4%	7	62.5	378,333	9.4%
Midwest	16.6x	178%	11.5%	33	30.9	102,749	10.6%
Northeast	16.8x	175%	11.5%	9	71.5	435,907	10.8%
Southeast	16.9x	152%	9.0%	19	41.4	224,546	11.2%
West	10.5x	151%	5.5%	1	157.4	1,288,454	11.3%
National Community Banks	**16.3x**	**163%**	**9.5%**	**69**	**63.0**	**189,126**	**10.4%**

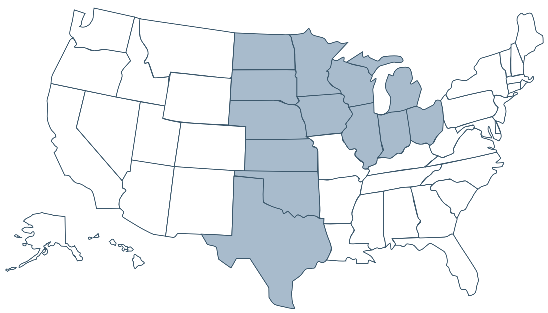
Source: S&P Global Market Intelligence

Mercer Capital's Regional Public Bank Peer Reports

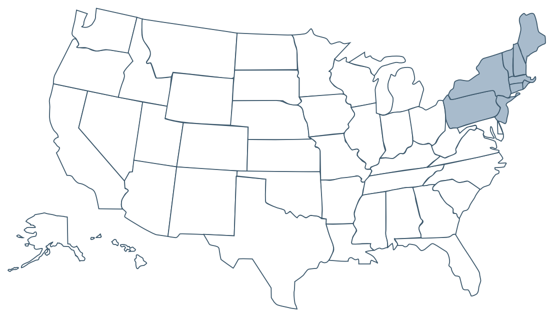
Updated weekly, Mercer Capital's Regional Public Bank Peer Reports offer a closer look at the market pricing and performance of publicly traded banks in the states of five U.S. regions. Click on the map to view the reports from the representative region.



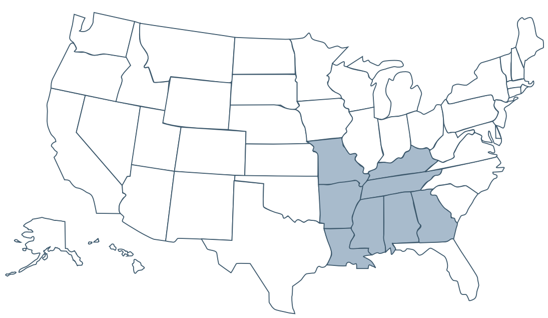
Atlantic Coast



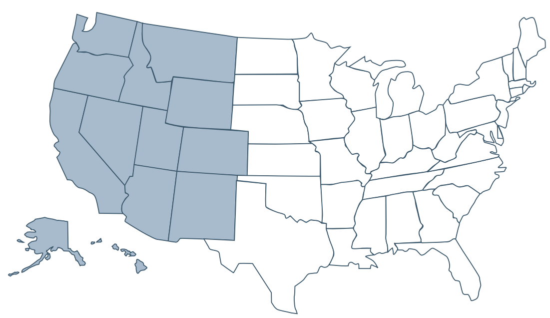
Midwest



Northeast



Southeast



West

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Mercer Capital assists banks, thrifts, and credit unions with significant corporate valuation requirements, transaction advisory services, and other strategic decisions.

Mercer Capital pairs analytical rigor with industry knowledge to deliver unique insight into issues facing banks. These insights underpin the valuation analyses that are at the heart of Mercer Capital's services to depository institutions.

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- Financial reporting for banks
- Goodwill impairment
- Litigation support
- Stress Testing
- Loan portfolio valuation
- Tax compliance
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- Strategic planning

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