Crowe Horwath.

Four Lessons Learned From M&A

By Rick L. Childs, CFA, CPA, and Larry S. Raber, CPA, Crowe Horwath

Bank mergers and acquisitions are complicated and can affect capital and earnings post-transaction. Following are a few lessons learned about the acquisition process and the potential issues that can arise. Paying close attention to these issues during planning and due diligence can set an acquisition on strong ground as the deal closes.

In the Crowe Horwath LLP and Bank Director October 2013 Bank M&A Survey, respondents listed several barriers that prevent agreement during an acquisition. Among the top concerns were the seller's credit quality and the buyer's ability to integrate operations effectively. For respondents who completed an acquisition during their time on the board, the following issues were deemed difficult to manage:

- Due diligence
- Credit quality
- Social and cultural issues
- Post-merger integration

Due Diligence

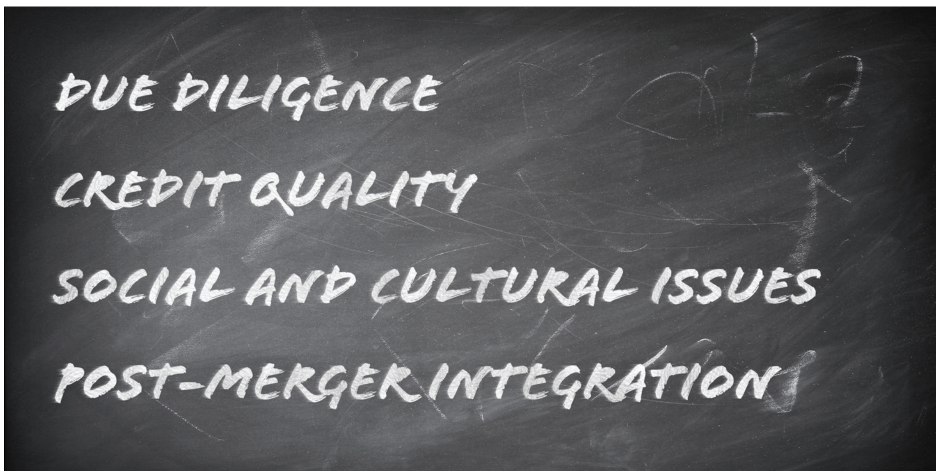
Comprehensive credit due diligence is probably the most important aspect of due diligence. When assessing due diligence issues, two concerns are raised repeatedly: getting an accurate picture of how much credit concern exists and translating the credit concern information into forward-looking models that can affect the price paid for an acquisition.

Credit due diligence reviews work well when a team of internal credit review specialists from the acquiring bank is paired with external loan review professionals who have done loan review due diligence for other deals. Resource limitations sometimes will prompt a bank to outsource the entire review. Although a full external review can produce fine results, the bank's credit team should be involved with evaluating the portfolio being acquired, considering that the team will have to live with the loans post-transaction. Outside professionals can serve to validate the internal team's view of the portfolio. They also can be helpful when segments of the portfolio are outside the acquiring bank's expertise.

Related to and almost as important as credit due diligence is assessing the potential cost savings. A buyer's ability to identify and execute on identified cost saving opportunities plays a large part in how the market reacts to the merger and whether the buyer can achieve expected earnings accretion for existing shareholders. Both a top-down and bottom-up approach are needed to make sure the new institution is right-sized from the start.

Credit Quality

Converting credit due diligence into projections and pricing requires combining what the credit does with the requirements for accounting for the transaction post the deal closing. In many cases, management heavily relies on the credit due diligence review team to evaluate the loan portfolio. Credit review teams generally use an identified loss approach that is more applicable to an allowance for loan loss methodology. Alternatively, a range of life-to-date loss projections can be presented as a best- or worst-case scenario to evaluate the transaction's overall merits. The simple credit mark approach often neglects the timing of loan cash flows as well as the market-required rates of return on those cash flows. Additionally, credit review teams might provide the potential loss only should a default occur but not the corresponding probability of default, which is an important driver of potential losses at the selling institution.



To avoid last-minute surprises, more institutions with extensive acquisition experience are involving their third-party valuation teams earlier in the process – during the due diligence phase – to provide preliminary valuations.

Social and Cultural Issues

Social issues often are the hardest to manage because the factors can vary so much from bank to bank. Though there are many ways to address social issues, spending time with the leaders and line managers of the selling bank will provide a better understanding of potential social and cultural integration issues. Areas to focus on include:

1. Management style
2. Decision-making process
3. Degree of customer commitment
4. Entrepreneurial spirit
5. Innovation, creativity, and speed to market
6. Value of teamwork and collaboration
7. Leadership accessibility
8. Performance accountability system

It can be helpful to create a side-by-side comparison of how the processes and culture on these issues work at each institution. If there is little overlap among the two institutions, the social issues might be too severe to overcome.

Post-Merger Integration

Executing post-merger integration is difficult and has derailed a number of transactions. The following seven rules can help achieve a successful transition:

1. Base the transition strategy on executing to the value drivers on which the acquisition was based.
2. Aggressively manage communication to answer stakeholder questions and get stakeholder acceptance.
3. Launch small, fast-paced task forces that accelerate implementation of the opportunities most likely to positively affect the new institution.
4. Align roles and responsibilities to make sure the direction the organization is heading in is clear.
5. Build and reward behavior around important events and milestones that ultimately will have the biggest impact on the institution.
6. Assign people to be role models of the desired culture.
7. Link incentives with actions that promote the bank’s plan and help realize the transaction’s value.

Planning for and executing bank M&As can be fraught with potential for miscues, but careful planning, education, and experts’ involvement where beneficial can help manage the process and make for a smoother acquisition and assimilation.

Contact Information

Rick Childs is a director with Crowe Horwath LLP in the Indianapolis office. He can be reached at 317.706.2654 or rick.childs@crowehorwath.com.

Larry Raber is a partner with Crowe in the Sacramento, Calif., office. He can be reached at 916.492.5123 or larry.raber@crowehorwath.com.

Originally published in the February 2014 WIB CFO & Finance Digest.

Published by Crowe Horwath LLP in May 2014.

Crowe Horwath LLP is an independent member of Crowe Horwath International, a Swiss verein. Each member firm of Crowe Horwath International is a separate and independent legal entity. Crowe Horwath LLP and its affiliates are not responsible or liable for any acts or omissions of Crowe Horwath International or any other member of Crowe Horwath International and specifically disclaim any and all responsibility or liability for acts or omissions of Crowe Horwath International or any other Crowe Horwath International member. Accountancy services in Kansas and North Carolina are rendered by Crowe Chizek LLP, which is not a member of Crowe Horwath International. This material is for informational purposes only and should not be construed as financial or legal advice. Please seek guidance specific to your organization from qualified advisers in your jurisdiction. © 2014 Crowe Horwath LLP

FS14910C