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White Paper

Five Keys to Analyzing Potential Bank or Branch Acquisitions

Exploring Financial and Market Perspectives

Growing revenue and profit for your financial institution is becoming more and more challenging. For many, deposit growth has outpaced loan growth, and while investment portfolios have grown, lower yields have caused a consistent decline in net interest margins. But even in the current banking climate, bank and branch acquisition–done correctly–can be a pathway to growth for your organization

In recent years, acquisition has become an important trend in the banking industry. Since 2007, the FDIC reports there has been a 14 percent decline in the number of bank organizations and assets continue to concentrate into banks that have total assets exceeding $1 billion. Clearly, a way to achieve future growth is to acquire other financial institutions or branches, either in your current market footprint or elsewhere.

How to Think About Acquisition

Given industry trends, bank and branch acquisitions must accomplish these objectives:

- Facilitate core franchise growth–This is true not only in the short term with the acquisition, but in the long term through access to further growth in your markets.
- Be accretive to earnings in the long term–Make sure your pro forma projections for the acquisition are supported by solid market analysis and growth assumptions.
- Improve efficiency in the long term–Competitive pressures from larger banks with scale will dictate this but so will the expectations of customers who are embracing the flexibility and convenience of digital channels. You must be prepared to address both.

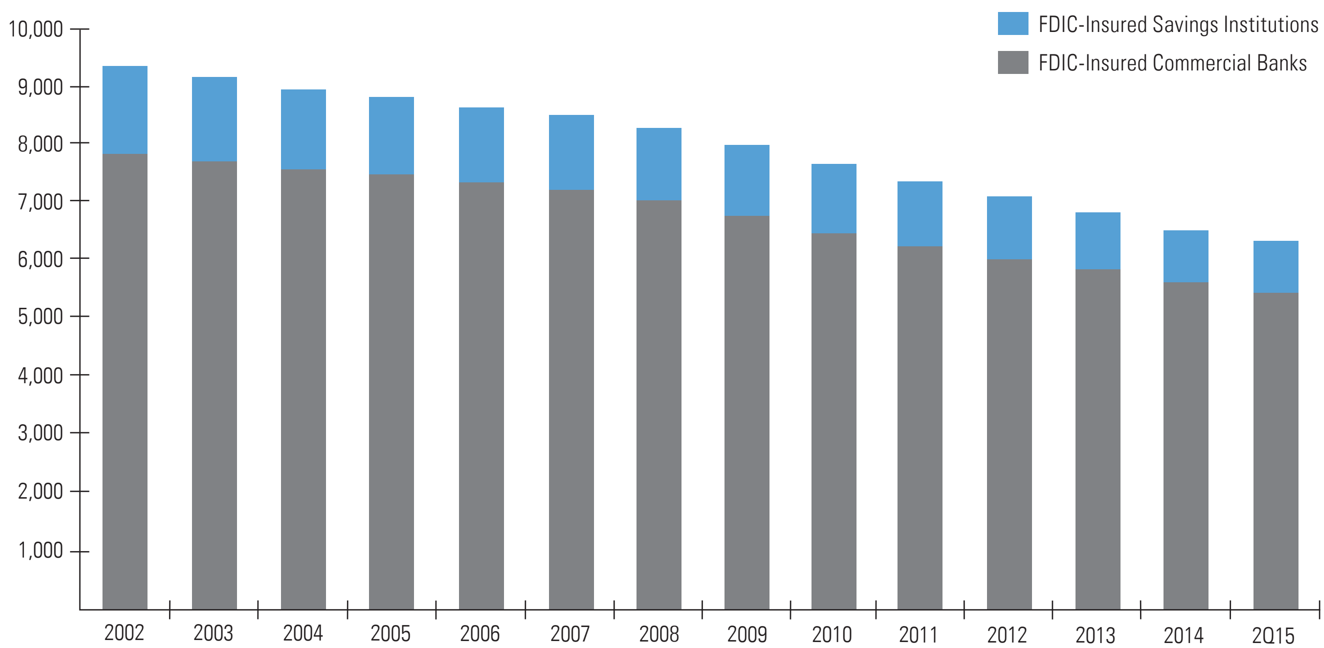
By effectively using data analytics to define strategic objectives and identify acquisition opportunities, you can improve the odds of identifying suitable acquisition targets and defining successful strategies.

Effective Branch Acquisition Analysis: The Right Data Upfront

Too often, financial institutions find themselves well along in the process of acquiring new locations before they have seriously considered whether the proposed market mix is even a good fit. To prevent this situation, your leadership should commit to an orderly, methodical investigative

Figure 1: The Impact of Consolidation on the Number of U.S. Banks and Savings Institutions

U.S. Banks for Commercial Banks and Savings Institutions, 2002-2Q15



Source: FDIC: FFIEC Call Report

process that yields highly credible data to facilitate an informed decision. Fiserv recommends an analytical approach consisting of five keys that unlock data you should examine as you consider any acquisition.

Financial Keys

The first two keys have to do with financial benchmarks important to your financial institution and your plan for growth.

Key No. 1: Defining Revenue and Earnings Objectives

The major drivers of revenue expansion are loan and deposit growth and mix, as well as fee income mix. As you look for possible acquisition targets, make sure the acquired business will complement your current operating strategy, enhancing franchise and revenue growth. Follow these steps:

- Create a "strategic peer group" of financial institutions. This group should have your major lines of business, play to your strengths and have a history of reaching earnings and efficiency objectives similar to or better than yours over the past three years. Using a tool like BankAnalyst® Financial from Fiserv can bring efficiency to this process.

- Validate the performance results of the strategic peer group. Compare your institution's key performance metrics (ROA, ROE, loan mix, fee income mix, funding mix) to the strategic peer group's mix. Identify those metrics that can be improved and any strategy shifts that might be desirable. Eliminate outlier financial institutions from the peer group. Use the strategic peer group for goal setting in the following steps.
- Set your loan mix, funding mix and growth objectives using the strategic peer group's results. These goals will embrace key portfolios such as commercial real estate loans, residential real estate loans, DDA and money market accounts. The target acquisition should help close your financial institution's mix gaps relative to the peer group.
- Set wealth management income objectives using the strategic peer group's results. If you have strong wealth management objectives, identify acquisition targets in markets that will provide a good mix of households requiring wealth management services.

Key No. 2: Defining Risk Management Objectives

Using the risk metrics of the strategic peer group, determine if you can improve your risk profile with a strategic acquisition. There are a number of risk metrics that must be evaluated in an acquisition. In a strategic acquisition, however, capital and strategic metrics, such as portfolio concentrations and diversification, tend to be overriding.

Check Capital Metrics

Do you have enough capital to acquire a target and preserve strong capital levels after acquisition? The transaction itself may generate capital, but purchase accounting sometimes exhausts more than some financial institutions expect. Having extra capital helps scope the size of the target and also helps in your conversations with regulators.

Check Strategic Risk

What effect will an acquisition have on loan concentrations for the combined bank? Will noncore fund dependency be improved? These are the types of questions management will have to address in seeking approval for a deal. Factors to consider:

- Loan mix–Will the acquisition cause you to exceed your risk tolerances in any of your loan portfolio categories? Will it help you improve your portfolio diversification?
- Funding mix–Core deposit funding is a key determinant of franchise value. Does the target acquisition improve your core funding mix?
- Revenue mix–Will the acquisition reduce your dependency on net interest margin by increasing recurring fee income? Will your net interest margin become more or less rate sensitive after the acquisition?

Once you understand your financial and risk objectives based on the analysis of your strategic peer group and have defined your goals, you can mine the market data to find the best acquisition targets.

Market Keys

When analyzing the targeted bank or branch markets, there are several important factors to consider. These will be based on your financial institution's unique operating structure–including opportunities for specialized business lines important to you, such as wealth management or mortgage. It is important to adopt and apply a consistent list of factors as you compare multiple opportunities, which will help you compare your options rationally and make the best choice.

The market evaluation related to an acquisition is an essential component of due diligence and is vital to creating realistic pro formas. While demographic data is available from a variety of sources, a tool such as

BankAnalyst Market from Fiserv combines those multiple sources and helps draw conclusions about the market's potential.

Take the following market factors into account as you make your evaluation.

Geography of the Combined Branch Network

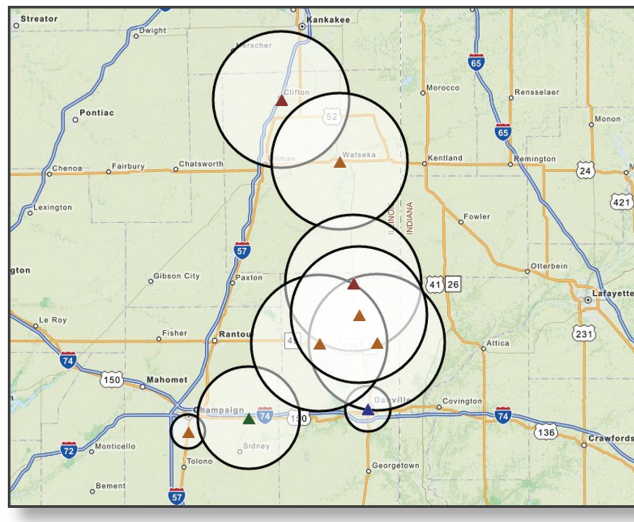
The density of a branch footprint has a direct impact on brand recognition and convenience to current and prospective customers. Mapping your existing sites and potential sites will help you understand if you are improving that density or creating outliers within your footprint. In unfamiliar markets, have team members visit the site to check on factors such as branch condition, ingress and egress, visibility and other attributes. Also keep in mind that in an entirely new market, you will have to establish brand identity and reputation in that market, adding marketing-related costs to your pro formas.

Branch Optimization

Once you know how the branches fit into your existing footprint, you can evaluate that footprint for optimization opportunities. An acquisition allows you to close or consolidate branches, but these choices must also be made after proper analysis. When you have to choose between two branches in close proximity, for example, it's important to look at performance factors at both locations. A branch with only $4 million in deposits may nevertheless be the current-day transaction hub of the market, whereas an established headquarters branch may actually be past its prime. Try to be consistent and measure known facts like the cost of deposits, transaction rates and branch operating costs (see Figure 2).

Having considered both geography and potential branch optimization, you're ready to explore the three market keys.

Figure 2: Evaluate Existing and Potential Branches to Determine the Best Sites



Key No. 3: Evaluating the Target's Market Share and Position

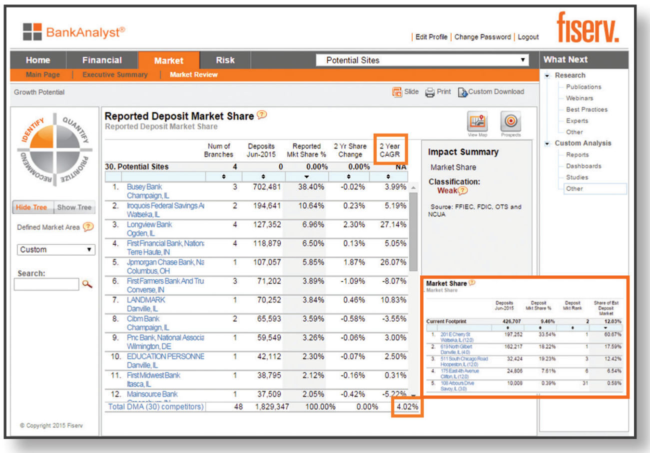
It's important to know the competitive saturation in a market as you consider entering it. The U.S. average market saturation is about 1,163 households and businesses per branch. It will be more difficult to compete in markets with substantially fewer households and businesses.

FDIC Summary of Deposit data gives an ideal look at the size and performance of the branches you are considering (see Figure 3). While FDIC data is reported at the branch level, a tool like BankAnalyst Market provides a more granular view of the entire bank's footprint market share alongside all competitors in the market. This helps to more clearly understand who the competitors are and align your pricing and fee structures with what is currently in the market.

Key No. 4: Evaluating Customer Segments

In addition to ensuring your products and services are competitive, you need to understand the customer segments that make up the new market.

Figure 3: Evaluating Market Share and Position



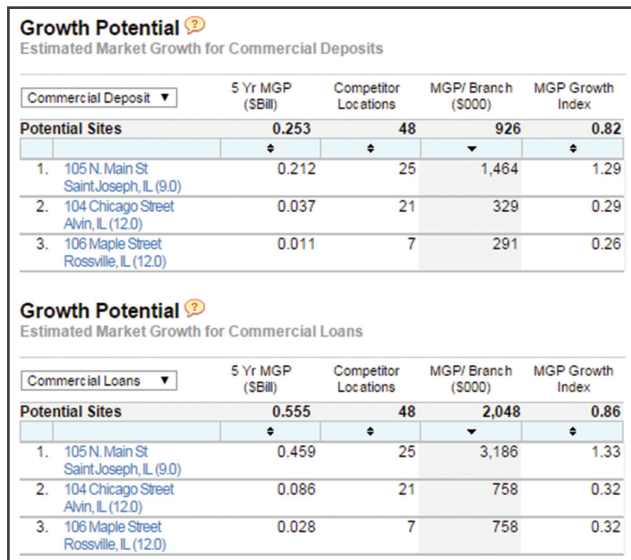
A tool like BancAnalyst can compare a financial institution's footprint and market share against competitors in the market.

- Consumer—Are the consumers in the new market similar to those in your existing market, or are they different in important ways? Ensure you have the products, service and internal training necessary to meet the needs of a new segment of consumers.
- Commercial—What industries are prevalent in the market? Are your products, services and underwriting processes a good fit? Look for a balance in the market's profile that offers opportunities to diversify your commercial, industrial and commercial real estate portfolios.

Key No. 5: Evaluating the Target Market's Impact on Your Existing Franchise

The final piece of data to evaluate relates to growth potential at the new branch locations and alignment with the goals of your existing franchise. You've looked at projected growth rates based on factors like the number of households and businesses, revenue figures and so on. But how do you know what these will mean to branch performance in real terms? Specialized software like the BankAnalyst Market tool merges all of these projections and quantifies them into a Market Growth Potential rating by branch (see Figure 4). Combining the total growth projection in the market, and adding the competitive factor to show the growth per branch office, provides a measurement that can be a valuable addition to your strategic planning. If the average growth surrounding your target sites is higher than your existing branches, acquiring these locations should add to your overall growth potential.

Figure 4: Understanding a Target Market's Potential Impact



Growth Potential
Estimated Market Growth for Commercial Deposits

Commercial Deposit	5 Yr MGP ($Bill)	Competitor Locations	MGP/ Branch ($000)	MGP Growth Index
Potential Sites	**0.253**	**48**	**926**	**0.82**
1. 105 N. Main St Saint Joseph, IL (9.0)	0.212	25	1,464	1.29
2. 104 Chicago Street Alvin, IL (12.0)	0.037	21	329	0.29
3. 106 Maple Street Rossville, IL (12.0)	0.011	7	291	0.26

Growth Potential
Estimated Market Growth for Commercial Loans

Commercial Loans	5 Yr MGP ($Bill)	Competitor Locations	MGP/ Branch ($000)	MGP Growth Index
Potential Sites	**0.555**	**48**	**2,048**	**0.86**
1. 105 N. Main St Saint Joseph, IL (9.0)	0.459	25	3,186	1.33
2. 104 Chicago Street Alvin, IL (12.0)	0.086	21	758	0.32
3. 106 Maple Street Rossville, IL (12.0)	0.028	7	758	0.32

An example from BancAnalyst Market tool, which helps financial institutions understand the potential market growth potential per branch at a consumer or commercial level.

Matching Opportunities With Objectives

Given today's challenging markets and industry trends, acquisition activity is sure to increase. As your financial institution explores opportunities in this arena, it's important to establish clear objectives. Select acquisition targets that can facilitate core franchise growth, add to earnings and improve long-term efficiency. Having a plan in place to analyze both the financial and market data will help you ensure your targets are able to fulfill your short- and long-term objectives.

About the Authors

Grey Winstead is a senior strategist with Bank Intelligence Solutions, Fiserv. He has more than 30 years of experience in the executive management of six successful community banks. His merger and acquisition experience includes both the sale and purchase of community banks, including due diligence, valuations, negotiations, closing and merger integration.

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