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Client Alert

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"Trump Bump" Influences Bank M&A Market

Within 36 hours of Donald Trump's surprise electoral victory, the stock market began a rapid ascent. Mr. Trump's campaign promises of less regulation, large infrastructure spending and tax cuts have resonated on Wall Street, causing a wave of optimism that has driven up prices for most publicly-traded stocks. During the period from Mr. Trump's election to March 1, 2017, the Dow Jones Industrial Average rose over 15%, and the S&P 500 rose over 12%.

Further, calls to repeal many of the requirements of the Dodd-Frank Act (which disproportionately affected financial institutions), together with likely increases in short-term interest rates have led to a recent surge in bank stock pricing. Both the KBW Nasdaq Bank Index and the KBW Nasdaq Regional Banking Index have risen more than 30% from the election date to March 1, 2017.

This has filtered into pricing in the bank M&A markets. According to a recent article in AmericanBanker.com, Global Market Intelligence counted 37 bank mergers announced through February 28, 2017, with a median price-to-tangible-book ratio of 165%. That compares with 132% last year, including 125% in the first quarter.

What does this mean for bank buyers and sellers?

A potential buyer should use the "Trump Bump" as an opportunity to pursue candidates on its short list – the targets that would be the best fit for the buyer's franchise. If the buyer's common shares are publicly traded and have increased in value as a result of the Trump Bump, the increase in value may give the buyer an opportunity to bridge a pricing gap that may have otherwise existed.

Even if the buyer's stock is not publicly traded, the Trump Bump appears to have trickled down (albeit on a less consistent basis) to banks in metro-markets. Private company buyers may also be able to use their stock as currency to make acquisitions or to consider mergers of equals or strategic combinations. With the rise in valuations, however, cash buyers may have more difficulty in making deals happen.

On the other side of the transaction, a potentially seller should be cautious in considering transactions principally in stock. While the Trump Bump represents a dramatic rise in valuations in the short term, the fundamentals typically relating to bank valuations have not improved significantly since the election. Instead, the markets appear to be somewhat caught up in betting on the come based on expectations for:

- inflation and interest rate increases,
- infrastructure and government spending expanding GDP,
- tax relief, and
- regulatory relief.

As a result, it is not certain how long this Trump Bump may last. We have already seen the markets retreat somewhat from the record highs at the beginning of this month. If the optimism regarding Mr. Trump's campaign promises begins to wane, could we face a "Trump Slump"?

Because almost all bank acquisitions involve some type of regulatory approval, these deals do not happen overnight. Instead, there almost always is an extended period from when the terms of the deal are set to when the deal closes. If there is a market retreat, the seller does not want to be stuck with a price determined during an overheated market. As a result, it is very important for a seller to make sure it has protection (such as a floor or a collar) that will either adjust the consideration delivered or give the seller the opportunity to walk away from the deal or a sufficient deal premium to withstand a market correction.

In addition, with increased pricing, buyers may become more aggressive in pursuing their targets, whether the target wants to sell or not. (We have already seen an increase in unsolicited offers for community banks since the election.) If a buyer makes an offer for a target, it means that the buyer thinks it is the best time for the buyer to buy. It does not necessarily mean that it is the best time for the seller to sell.

In order to provide the seller with the flexibility to "just say no" to an unsolicited offer, the seller needs to be operating under a well thought-out strategic plan by which its board has determined now is not the time to sell. As a result, sellers may want to dust off their strategic plans to make sure this defense is available.

The Trump Bump appears to have increased conversations between buyers and sellers. But it is still too early to tell if it will lead to more deals. Many of Mr. Trump's campaign promises weigh in favor of greater bank performance, and thus, perhaps banks more willing to remain independent. It is too soon to tell if the favorable pricing from the Trump Bump will outweigh the potential tail winds of change.

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