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Going Solo, Pairing Up: Community Bank Specialists Discuss M&A

SNL recently spoke with Robert Pachence and Matthew Resch, managing directors at Ambassador Partners LLC unit Ambassador Financial Group Inc. The Allentown, Pa.-based firm recently expanded with the addition of Danielson Associates LLC. In addition to community banks, the combined company will serve a range of financial institutions, including insurance companies and asset managers.

What follows is an edited transcript of that conversation.

SNL Financial: In terms of the addition of Danielson ... why did you decide on this route over other options you may have taken?

Robert Pachence: We talked to a number of investment bankers and started talking to Danielson in early March about what their future plans are and what our plans are, and they really kind of meshed together. We do some investment banking, and investment banking and fixed income are a great business model for us together. We've kind of dabbled in the space, although obviously the environment hasn't been the greatest. But as we are always planning for the future, we wanted to expand our current platform and spent the past year or so discussing what options we wanted to do to build up our current model.

Will this deal allow Ambassador to expand geographically?

Pachence: Our customer base is primarily located in the Northeast. Dave [Danielson]'s customer base is in the Northeast but also in the mid-Atlantic region, so in addition to expanding the investment banking platform we'll also be able to expand our customer base geographically. So we may be able to expand our fixed-income business into the mid-Atlantic states.

What convinces you that Ambassador will continue to be successful?

Pachence: There's always room for a financial services company with fresh ideas, tremendous execution and tremendous pricing to come into the fold, and I think now is the time when you can certainly do that.

Matthew Resch: The backbone of our business is the relationships that we have with our customers. It's completely client-centric. In the longer picture, it's also about the talented people we have in the organization. We're talking to people every day about joining us. Ultimately, we want to create a full-fledged capital markets division expanding on what our current success has been.

What do you advise community banks to do to lure customers away from the megabanks, which seem to be stumbling a bit?

Pachence: The reality is that many community banks are doing really well. A lot of them are trying to capitalize on the idea that sometimes banks sound like a four-letter word to people. These people in the communities really do care about the communities, and there's a very large disconnect between the large banks and the community banks. I think their core customers know that.

Resch: Our belief is that community banks are a core component to a healthy U.S. banking system. Regulation has certainly gotten in the way. There's all this talk that we have to get rid of these too-big-to-fail institutions, but clearly the net effect of the increasing legislation is going to be consolidation. And ultimately you'll be creating fewer institutions, which will be much larger. On one hand, the regulators say they want to get rid of the too big to fail, but on the other hand, their actions will create fewer institutions.

What do community banks need to do better in terms of their balance sheets?

Pachence: I think a lot of bankers are just beat down. Maybe banking isn't as fun today as it was a couple years ago. I would hope that people wouldn't throw in the towel or put their head in the sand. I think getting the word out that they're there for the community and they're there for the long term ... that's something I'd like to see them promote a little more.

Resch: Banks are sitting on more liquidity than they've ever had, and now you're looking at a flatter yield curve. We think margin compression is going to be a story going forward to eat into the potential profitability. I think banks have to get creative in the decisions they make to book assets. If the loan demand is not there, there are things they can do on the wholesale side of the balance sheet within their fixed-income investment portfolio to perhaps invest into securities or sectors that almost act as a loan surrogate.

How do you persuade a bank to raise capital in this environment?

Pachence: You have to weigh the pros and cons. You might have shareholders who have invested in a bank and now these shares are way below book.

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If people around the table can maybe put up some money, that might be a great opportunity for people to get into these institutions, even if there might be some dilution. But if current shareholders want to put in some more money, that's great. If you get into an institution that's trading at such low levels and all new shareholders want to come in ... there's got to be some really good planning as to what are you going to do to your current shareholders and what do you do to your current book value and what is the price that's realistic to get these deals done? If it's priced right and the parameters are all set, there will be buyers.

Resch: There are creative ways that banks can access capital. We feel strongly that there's a lot of capital available out there for banks. If a bank is in a good market and has good market share and a good management team and a good story to tell, there's certainly capital out there.

What kind of timeline are you anticipating for consolidation in the industry?

Pachence: Everyone is talking about this wave of M&A coming, but it really feels like a ripple. The environment is one that there are a lot of tired institutions out there, but the other side of it is, who are the buyers? Some of the buyers you think would be there ... maybe their currency isn't trading where it should be and it makes it hard to get a deal done. Do we anticipate a huge wave of M&A consolidation? Personally, I don't think so. There still are a lot of sellers out there who want that magical two-and-a-half times book, and it's not going to happen nowadays.

Resch: Every argument that investment bankers can make as to why M&A should pick up ... and you couple that with a flattening yield curve, you would think it would cause an uptick in M&A, but there's still a significant difference in pricing. The one catalyst that might cause M&A to pick up is that some banks have board fatigue. The fact is that we're a number of years away from multiples really accelerating so there might be situations where banks are throwing in the towel and want to trade their currency for a larger organization, so that could be the impetus. But I still think we're a little ways off from having M&A like we saw in the late '90s.

How do you persuade a bank that maybe isn't severely troubled to agree to a merger of equals?

Pachence: Those deals are all about the social issues. You're going to try to do one plus one equals three. It comes down to how do the personalities play?

We're telling people to always have conversations with people. We're not at that point yet where a lot of institutions really feel the need to do something.

Mergers of equals could be a great strategy for a lot of institutions, but until there's a need for them to really do something and the social issues all mesh together, you have to wait for those deals to happen.

What does it take to push boards to make that jump?

Resch: You have to find the perfect situation where one of the CEOs is willing to take a back seat. When you're having those conversations, you're looking for who is going to run the combined institution. There's no magic formula, and it really has to be a unique circumstance where the boards get along and are on the same page as to what the combined situation is going to look like.

Are de novo launches becoming a thing of the past?

Pachence: Until we work through the remaining credit problems that institutions have, I think we're going to be hard-pressed to see many new banks and new bank charters. Regulators would like to see available capital shoring up the banking system and making some of the institutions that do need capital stronger. ... Maybe the money goes there instead of handing out new charters.