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NASHVILLE NOTES

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Investors will have no one to blame but themselves

By Jeff K. Davis

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I once heard a friend in the investment management business quip in 2006 that value stocks were no value and growth stocks were not growing. Depending upon the sector, the thought may apply today; I think it applies to most banks.

Investing in banks usually attracts the "value" crowd. Buy at a "reasonable" valuation, clip the dividend coupon each quarter, and let value accrete with EPS and tangible book value per share over time. If the sector or individual stocks are "cheap" then identifying the catalyst that will drive multiple expansion to the mean (or above it) is the equivalent of alpha-generation for a value investor.

Commercial banking usually is a slow- to moderate-growth proposition — if not a boring one except when industrywide credit issues develop. However, what many investors crave is growth, not value. Growth investors are not careless; they care about growth at a reasonable price, and they especially value accelerating growth because that can become the catalyst for big-time gains. Today, I think many bank investors are anxious for better growth, in part, because the stocks do not seem like safe-haven value plays.

So a number of comments at the Gulf South Bank Conference in early May caught my attention as it relates to growth. For years executives at the conference have touted the merits of the region. Many of the Gulf banking markets extending from Texas through Florida are legitimate growth markets with world-class ports and population growth rates that exceed the U.S. as a whole. Banks in the region have grown over the decades with development of the economy, punctuated by periodic busts in real estate and energy prices. However, because the industry is over-banked and offers sizable expense synergies from consolidation, M&A is always a topic that gets a lot of airtime at the conference, too.

I think every executive I saw spoke about M&A as a buyer. But what really caught my attention this year were a few comments related to growth and M&A accounting. For instance, Yadkin Financial Corp. CEO Scott Custer referenced the positive impact that fair value marks applied to acquired assets still had on his bank's NIM and earnings. Hancock Holding Co. has discussed the issue a lot since acquiring Whitney Holding Corp. in 2011.

There is nothing unseemly about the accounting or how most banks disclose its impact because the disclosure usually is straightforward about the impact on the NIM. Nor should there be any surprise that accretion wanes with time as marked assets convert to cash. However, where I think some investors and many sell-side analysts are going to be caught flat-footed is the gap between where the reported NIM has been, where it will reset in the current rate environment, and what the difference will mean for perceptions of earning power. It is not good.

That may be harsh, but I have mused for some time in this column that I believe yields and NIMs will fall much further than the Street believes possible because of the impact of the Fed's zero-rate policies. SNL's Nathan Stovall and Zuhaib Gull had a great post on the subject recently that noted NIMs were near 25-year lows. Unfortunately, I do not think the bottom is in yet because banks remain willing to lend at very modest yields, while core deposits and especially noninterest bearing deposits add little to the NIM when rates are anchored to zero.

What are the implications? Know what you own. Good and bad trends start at the margin. The NIM "story" for the industry is becoming a major one, but it has been foreseeable for a long time absent a pivot by the Fed. Some growth stories may prove not to be growth stocks, and some value stocks may be less of a value as analysts slowly lower estimates based upon an outlook that is predicated on change over a quarter or two rather than a couple of years. The one really important variable that an investor controls is price paid. Growth matters over the long-term, but maybe value matters more now.

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