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National Commerce's history rhymes a lot with Alabama National BanCorp.'s

By Jeff K. Davis

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So far this year, three commercial banks have priced IPOs: Nashville-based Avenue Financial Holdings Inc. and Franklin Financial Network Inc., plus Birmingham, Ala.-based National Commerce Corp. Earlier this year, I commented on Avenue and Franklin Financial. I view both as growth companies, albeit with different models, in a sector that is devoid of growth. National Commerce is a growth company, too. It is linked via history with its quasi legacy predecessor, Alabama National BanCorp., which was known among investors as the two-syllable ticker "A-LAB." As a Deep South company, the A was a very long A.

National Commerce is led by Chairman and CEO John Holcomb. I first met him in 1993 when I called on him when he was CEO of then privately held National Bank of Commerce of Birmingham. At the time I was 30. I am not sure why he took the meeting, but I appreciated it. I do not remember exactly what we talked about, but to this day I remember making a mental note as I walked out that I was impressed by him, the turnaround in what had been an underperforming Birmingham bank his team had engineered and his views on how to create value. It was a couple of years before NBC parent National Commerce Corp. and an affiliate holding company, Commerce Bankshares Inc., merged with publicly-traded Alabama National Bancorporation in late 1995. As a result, National Commerce and Commerce Corporation shareholders gained control of Alabama National. (Although it is not germane to the story, some may be confused by names because National Commerce Bank of Birmingham, which was the lead bank within ALAB's multi-bank holding company, merged with ALAB subsidiary First American Bank and took its name.)

ALAB became a great money-maker for bank investors over the years that I covered it for J.C. Bradford & Co. and FTN Midwest Securities. Among bank investors, it had a cult-like following for a reason: revenue growth, minimal credit losses, fee income diversity and a knack for making smallish acquisitions that worked without many outwardly visible issues. After a great run, the board decided to sell the company to Royal Bank of Canada for $1.67 billion, or $80.00 per share at announcement, during September 2007. The return from year-end 1996 when the shares closed at $17.75 per share and had a market cap of $179 million through the announced deal value was 450%. The return was over 500% inclusive of dividends, which increased from 28 cents per share in 1996 to $1.64 per share declared in 2007.

Who knows how much history will repeat, but the National Commerce roadmap is similar to ALAB's, beginning with the merger of the old National Commerce with ALAB in 1995. After RBC acquired ALAB in February 2008, the core of the executive team eventually left. They later partnered with key ALAB shareholders to recapitalize Americus Financial Services Inc. and its then-troubled subsidiary Red Mountain Bank, via a $58 million investment in 2010. With new management and a new majority ownership group, Americus became National Commerce Corp. and Red Mountain Bank became National Bank of Commerce.

The past is no guarantee, but Mark Twain's quip about history rhyming seems to be spot-on with National Commerce. I see several themes and fundamentals that are common to ALAB's and which I think will drive better-than-average long-term performance for National Commerce's shares.

One is an explicit value-based approach to management. The principles are listed near the front of National Commerce's S-1. The first one deals with management and employees as shareowners and the high level of insider ownership (31%). The second states that the primary purpose of the company is to create value for the shareowners without any apology or hedging.

Another value is the explicit link of strong credit quality and risk management to the creation of shareholder wealth. ALAB's annual net charge-offs ranged between 0.00% and 0.18% of average loans during 1996-2006. While that was a period of good asset quality for the U.S. banks, I think ALAB's superb performance partially can be ascribed to another explicit principle: a culture of candor. If my memory is correct, ALAB management always put loans that were 90 days past due, whether over-collateralized or not, on non-accrual because such a situation indicated a serious issue with the borrower even if no loss was expected.

During August 2006 I gave a presentation to senior management at a retreat in Stone Mountain, Ga. It was my flyover view of the industry, the market for bank stocks, M&A and ALAB. Afterwards I was chatting with Holcomb and asked him what he thought. He offered candor. He said collateral values were falling in Florida and no one recognized it or would acknowledge it — a point that was missing from my slide deck. I was not quick enough on my feet to offer Synovus Financial Corp. management given their unfolding Florida disaster, but he was right. Less than a year later, the board agreed to sell the company to RBC in a well-timed exit from heavy exposure to Florida and Georgia.

Another common theme between ALAB and National Commerce is the importance of markets and growth potential. ALAB primarily operated in Alabama, Florida and Georgia. Today, National Commerce has banking offices in Alabama and Florida that largely are staffed by ex-ALAB managers. One of the underlying themes for ALAB was that its subsidiary banks had a commercial focus in high growth markets where ALAB had low market share.

Take share in a growth market and the result can be rapid growth as demonstrated by Pinnacle Financial Partners Inc. in Nashville and Signature Bank in New York City. National Commerce seems to be following a similar strategy with focused operations in Alabama and Florida. Maybe Georgia will be added later, but that may not matter vis-à-vis the opportunity to sustain above-average industry growth. National Commerce made two acquisitions last year. One was United Group Banking Co. of Florida, which operates in the Orlando area. The other was the acquisition of a 70% interest in the parent company of Corporate Billing, which began in 1995 as a subsidiary of ALAB's First American Bank unit. The S-1 notes that organic and acquisition growth are equally important.

I do not know how much the IPO was oversubscribed. The underwriters priced it on March 18 at $19.50 per share, which was the midpoint of its expected $18.50 to $20.50 per share range. Avenue Financial's IPO priced at the low end of its expected $11.00 to $13.00 per share range. Franklin Financial priced below its expected $24.00 to $27.00 per share range at $21.00 per share. National Commerce's price equated to 133% of pro forma tangible book value per share and 21.0x pro forma 2014 earnings adjusted for two mergers as if the mergers had occurred on Jan. 1, 2014.

It looks like to me the underwriters struck the right balance regardless of how one might feel about the valuation because the shares have since risen by 11.0% through April 2. Regardless of current "value" there are two things I have learned that the Street likes in a stock: growth and accelerating growth. National Commerce is not the only bank that operates in Georgia and Florida, but it seems like the old ALAB formula is in place to drive growth for National Commerce.

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