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Citigroup vs. MidSouth Bancorp corporate governance

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Longtime bank analyst and Wall Street naysayer Mike Mayo has skewered a number of bank management teams and boards over the years. More recently, he has focused on corporate governance (or maybe he always has but I have just noticed it recently). Two years ago, Bank of America Corp. was a target when he questioned corporate governance following the naming of CEO Brian Moynihan as chairman. This year, Citigroup Inc. is a target where he has a list of 10 questions related to governance and substandard profitability and therefore "worst-in-class" stock valuation.

They are legitimate questions. Aside from draining excess capital if it exists, Citi management would flip a switch to boost ROE if they could, but they cannot; nor can the board. Bank of America's profitability resides partly with the Fed. Higher short-term rates will increase the bank's NIM given its vast base of low-cost domestic deposits. Maybe corporate governance does not matter as much in Charlotte.

Elsewhere corporate governance has made news. AXA, which owns 64% of AllianceBernstein Holding LP, fired the CEO and a majority of the board members a few days ago. Earlier this year, the CEO and several directors of Banc of California Inc. resigned and/or decided not to stand for re-election for alleged ties to an individual charged with fraud.

Especially surprising to me was the April 27 announcement that Lafayette, La.-based MidSouth Bancorp Inc. terminated the employment of longtime President and CEO Rusty Cloutier as well as son Troy Cloutier, who served as President and CEO of MidSouth Bank. The announcement was made by Jake Delhomme, who was appointed chairman of both the holding company and subsidiary bank at year-end 2016. Delhomme replaced a chairman who had been in place since 1990. Whether it was corporate governance, a fresh set of eyes, or just dissatisfaction with the executives and returns, the board took decisive action.

Internal board dynamics are hard to discern for outside investors, even though some situations are seemingly obvious. I do not know how enthusiastic Director Leonard Abington was about terminating the Cloutiers' employment, but I suspect he is not happy about the performance of MidSouth's shares. Abington owns about 4% of the shares. He is the largest insider after the company's ESOP, which controls about 6% of the shares.

Abington joined the board after his company, PSB Financial Corp., was acquired by MidSouth on December 28, 2012. Since then, MidSouth's shares are roughly unchanged, while the SNL Small Cap Bank Index has risen 115% through May 3, 2017. The collapse in the price of oil from over $100 a barrel in 2014 to less than $30 a barrel at the bottom in February 2016 is an important fact given the company's direct and indirect exposure to the oil and gas industry. Nonetheless, it is probably a bitter pill, though not as bitter as when MidSouth's shares were trading around $7 per share when oil was near the bottom. For those who bought MidSouth's shares then, there should not be any such issues because the shares have doubled in a little over a year.

The rebound in the shares notwithstanding, there are no easy profitability fixes. MidSouth's ROE and ROTCE for the 12 months ended March 31, 2017, were 4.4% and 5.5%. The NIM is attractive at 4.1%, but an efficiency ratio greater than 70% is not. NPAs are high but have been steady-to-improved the past several quarters. Provision expense is high, but not high enough to produce quarterly losses. MidSouth Bank's capital is okay (9.5% leverage ratio), but the parent company has some leverage (and cash) in the form of trust preferred and 9% SBLF preferred that has to be serviced in addition to the common dividend. It is a muddle-along position for now that presumably gets better if oil trends higher; or gets worse if oil trades lower.

I think it is a reasonable question for investors to propose whether under the guise of corporate governance or just shareholder value: Will the board move to sell the company? If so, what price might be realized and how would that compare to remaining independent?

I, like everyone else, do not know what the future holds, but one can speculate. The supposition to the first question is that there are interested buyers. The logical ones are in-market competitors IBERIABANK Corp. and Hancock Holding Co., although IBERIBANK's No. 1 deposit market share position in the Lafayette MSA is problematic, if not prohibitive. Hancock has shown itself to be adept at picking up cheap Louisiana banking assets from First NBC Bank this year and Whitney Holding Corp. in 2011. MidSouth could make it a trifecta.

An MOE or quasi-MOE with an area bank such as Home Bancorp Inc. or Investar Holding Corp. is a possibility, though not especially appealing for shareholders vis-à-vis an acquisition. And a merger partner may not want additional energy exposure.

If the board elects to sell the company under the assumption (or assurance) there are available acquirers, my back of the envelope pricing has the shares worth $18 to $22 per share assuming 25% expense saves and $20 to $24 per share assuming 30% expense saves. The caveat is that there is not a big mark to the loan portfolio and that deal-related costs are not astronomical. I get the values based upon 10x to 12x subsidiary MidSouth Bank's net income adjusted for expense saves and a normalized (i.e., cut-in-half) loan loss provision, less the parent company's trust preferred securities and preferred shares net of the cash.

After a big run in the shares the past 15 months or so there still could be upside in a change-of-control, but there are a lot of "ifs" involved in the math and suitors. Plus, as I draft this, West Texas Intermediate Crude has fallen to around $45 from about $50 a barrel. I do not know if that is enough to matter to energy borrowers' ability to service their debt if the price stabilizes in the mid-$40s, but nearly half of the book was criticized as of March 31. I do know a key rule of deal making, like life, is this: Don't let other banks' problems become your problems.

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