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Closing another Southern banking chapter

By Jeff Davis

Jeff Davis, CFA, is a veteran bank analyst and SNL contributor. The views and opinions expressed in this piece are those of the author and do not necessarily represent the views of SNL or Mercer Capital, where he is the managing director of the financial institutions group.

On Sept. 6, SunTrust Banks Inc. announced that it was terminating forward purchase agreements that were put in place in July 2008 to lock in the value of the company's remaining 60 million Coca-Cola Co. shares. The early unwind netted SunTrust a $1.9 billion pretax gain in the third quarter, which was used to offset $725 million of charges for mortgage repurchase expense and write-downs of loans and investments. Also, 1 million Coca-Cola shares were contributed to the SunTrust Foundation.

The transaction did not receive too much play in the press, but it represented another milestone in the passing of 20th century Southern banking. I think the move ranks with the retirements of Wachovia's John Medlin, SouthTrust's Wallace Malone, and Hugh McColl of North Carolina National Bank and Bank of America Corp. in closing a storied history. The South entered the 20th century as the most backward region in the U.S, in terms of economic development. By the end of the century, the South had spent the final 25 years growing significantly faster than the rest of the U.S., though income and education levels in many areas still lagged national medians. And it was the efforts of hard charging bank CEOs that financed much of the growth. No city epitomized that growth like Atlanta, which snagged Delta Airlines from Birmingham in the 1940s when Delta left Monroe, La. Atlanta also navigated the turbulent Civil Rights movement era better than most Southern cities. SunTrust — primarily via predecessor Trust Co. of Georgia — was a big beneficiary of this growth, though the company was arguably more conservative with taking credit risks and engaging in aggressive acquisitions than its peers in Charlotte and perhaps Birmingham. And the 1985 merger with Orlando-based SunBanks Inc. added high growth Florida to the company's geographic mix.

Around 2000 or 2001, then-Synovus Financial Corp. CEO Jim Blanchard told me that he did not have to take as much credit risk as some peers because the company's 80% ownership interest in Total System Services Inc. provided a significant source of stable (and growing) earnings. I never heard anyone at SunTrust make a similar claim about the Coca-Cola position, but they easily could have done so. The shares represented a material source of reserve capital for decades.

The process of selling what was once a 98 million-share position officially began in 2007 as the company undertook efforts to fortify its capital position with the onset of the financial crisis. Under capital rules at the time, SunTrust could not count any of the Coca-Cola position as Tier 1 capital and was limited to 45% for purposes of Tier 2 capital. Rating agencies also discounted the position. The decision to sell an initial 9 million Coca-Cola shares in 2007 was probably not easy at the time, and it was an especially significant decision given the deep ties between the two companies.

SunTrust's ownership of the shares was the result of a predecessor company that kept some shares when it underwrote Coca-Cola's IPO in 1919. Cross board positions had been a long-time staple of the relationship between the companies. At the time of the decision to sell an initial block of shares in 2007, Coca-Cola's then-CEO Neville Isdell and former-CEO Doug Ivester sat on the SunTrust board; SunTrust's then-Chairman (and former CEO) Phil Humann sat on the board of Coca-Cola Enterprises; and former SunTrust CEO and Chairman James Williams sat on the Coca-Cola board.

It may have happened by accident, but the Coca-Cola investment was one of the great corporate investments of the 20th century by a bank. (The spawning of Metavante Technologies Inc. by Marshall & Ilsley Corp. and Total Systems by Synovus rank highly, too). By the time the Internet craze was accelerating in 1996, so too was the value of large-cap U.S. stocks. At times during 1997 and 1998, the value of SunTrust's Coca-Cola position rose to nearly $4 billion, with Coca-Cola trading around $40 per share. It then accounted for approximately 20% of SunTrust's market cap after the implied tax liability on a cost basis that was effectively nil. It might have been a good time to sell, with Coca-Cola trading for about 40x earnings then; however, the inability to spin out corporate assets tax-free under the "General Utilities Doctrine" following tax reform in 1986 probably precluded the board from efficiently monetizing the position, had they wanted to do so.

Coca-Cola also indirectly helped SunTrust in its periodic acquisitions, given the added premium the shares carried — though SunTrust never used the premium to acquire (or bid) in the same way Synovus did via its 80% interest in high-multiple Total Systems. At year-end 1995, SunTrust traded for 13x reported EPS vs. 11x excluding the value of Coca-Cola and the modest impact the annual dividend had on EPS. At year-end 1996, the relative multiples were 18x and 15x. The acquisition of Crestar Financial in 1998 and National Commerce in 2004, which pushed the share count to 361 million by year-end 2004 from 213 million at year-end 1997, diluted the impact of the Coca-Cola shares. So too did a long fall in Coca-Cola's shares from around $40 per share in the late 1990s to roughly $20 per share by year-end 2005. During the years from 2004 through 2006, Coca-Cola represented about 5% of SunTrust's market cap.

So, while tax restrictions and long-time business and social ties between SunTrust and Coca-Cola may have kept SunTrust from selling the shares in the late 1990s when Coca-Cola traded for astronomical multiples, management's timing looks to have been good with the shares trading around 20x current earnings. SunTrust was able to monetize the shares to augment capital in the midst of the worst financial crisis since the 1930s, and the $33 per share price cap in the 2008 forward purchase agreement is not too far below this year's $34-$40 per share trading range.

Jeff K. Davis, Managing Director of Mercer Capital's Financial Institutions Group, is a regular contributor to SNL Financial. He can be reached at jeffdavis@mercercapital.com.