NASHVILLE NOTES

First Horizon closes the book on large Memphis-based banks

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Assuming regulators do not derail the planned $13.4 billion cash acquisition of First Horizon Corp. by TD Bank Group, the acquisition of First Horizon will be the last deal for a major Memphis-based financial institution. Union Planters Corp. merged with Regions Financial Corp. in 2004, which then merged with AmSouth Bancorp. in 2006. SunTrust Banks Inc. acquired National Commerce Financial Corp. in 2004, then merged with BB&T Corp. in 2019 to form Truist Financial Corp.

Among nonbanks was the 2001 acquisition of regional broker Morgan Keegan & Co. by Regions, which Regions in turn sold to Raymond James Financial Inc. in 2012. Last year, Stifel Financial Corp. acquired institutional fixed income broker Vining Sparks IBG LP.

The story is similar in almost all if not all major and midsize cities around the U.S. Consolidation is inevitable given the importance of scale and efficiency to return on equity for shareholders.

Among the larger regional banks that likely will sell or merge in an MOE in coming years are Providence, R.I.-based Citizens Financial Group Inc.; Dallas-based Comerica Inc.; Cleveland-based KeyCorp; Columbus, Ohio-based Huntington Bancshares Inc.; Columbus, Georgia-based Synovus Financial Corp.; and of course Regions, which has a valuable Florida franchise, as does Synovus. Or more concisely — all of them in time.

Union Planters and First Horizon remained independent too long from a shareholder perspective with the benefit of hindsight, though when to exit is never known for sure on any given day. Morgan Keegan and National Commerce were near the top of their games when their boards decided to sell.

Consideration received matters, too, in addition to timing. Regions shares today are roughly unchanged from when the Morgan Keegan transaction closed on March 30, 2001. The same is true for SunTrust. As of March 11, 2022, Truist's closing share price equated to about $74 per SunTrust share, which is close to where SunTrust traded when the National Commerce transaction closed on Oct. 1, 2004. Both deals included some cash consideration, although the majority consisted of the buyers' common shares.

First Horizon shareholders will receive consideration that I think is great based upon the world as it exists today, and it may be spectacular if the world becomes unhinged due to the war in Europe. The deal values the shares at 2.1x projected closing tangible book value and 16.6x projected 2022 earnings. The one-day premium was 37% on the morning of the announcement, and there is no risk tied to TD's shares because the consideration to be paid to common shareholders solely is cash with a minimum price of $25.00 per share.

Would more be obtainable for shareholders if the board passed on the TD deal? We will never know. It has been a while, but First Horizon was a very high-performance company that was waylaid by the mortgage debacle that began to unfold in 2007. If one were to argue a higher price might be obtainable at a later date, then the stars probably would have to align for the company and the industry over the next few years as was the case in the 1990s.

I spent about a decade at FHN Financial, First Horizon's capital markets operations when the company had an equity capital markets operation. Before I joined FHN I was a sell-side analyst with Nashville-based J.C. Bradford & Co. I think it was the fall of 1999 when I was visiting with then CEO Ralph Horn in Memphis. I remember asking him why the company had not bought any banks in recent years. His answer then and now sticks with me.

He said banks were too expensive. According to S&P Global Market Intelligence data, the average price/tangible book value in 1998 was 2.8x and the median P/E based upon unadjusted earnings was about 23x. However, Horn said he could buy mortgage companies for 5-6x earnings.

He also said he had an 800-pound gorilla on his hands. At the time the company had three highly profitable business units: the commercial bank, institutional fixed income and the mortgage company. While he was acknowledging the strong performance of the mortgage company, I think he also was alluding to the growing political clout of the mortgage company with the board and some investors.

I do not remember if I offered a "yes, but" response to the cost of a bank acquisition because most deals then were structured as stock-swaps to qualify for pooling-of-interests accounting. Pricing was rich but buyers were issuing their richly valued shares. By the late 1990s, most banks traded at high multiples by today's standards. The operating environment was great, but there was an element of circular logic in which banks traded at elevated multiples because many were viewed as an acquisition target.

First Horizon's expansion strategy was largely organic rather than acquisition, predicated upon leveraging mortgage relationships into retail bank relationships and building offices in high growth markets such as Northern Virginia and Texas. Whatever the merits of the strategy, it was overwhelmed by the housing and mortgage disaster.

It worked for a while, however. The company made $473 million in 2003 on $25 billion of assets, and then about $450 million each of the next three years before the collapse. Last year, First Horizon's net income totaled $1.0 billion on about $89 billion of assets. ROE and ROTE precrisis were comfortably above 20% most years, while the shares rose to $40 on April 1, 2004, from $8 per share 10 years earlier.

Alternate histories can be appealing, but they are predicated upon something that did not happen. First Horizon could have sold at the top of its game, too, but when a company is making a boatload of money year after year it is not an obvious decision for any board. Plus, plenty of acquirers were waylaid by the Great Financial Crisis as was First Horizon. A handful of regional bank acquirers avoided big issues and rewarded shareholders, such as Capital One Financial Corp., but not many.

In any event, the board's decision to enter into the transaction with TD has lifted the stock enough that shareholder returns for the past one-, two-, five- and 10-years measured from March 11, 2022, are very competitive following a period when that was not the case.

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