Tuesday, November 06, 2012 8:25 AM CT 🗱 Blog

## KBW sale marks end of era

By Jeff K. 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.

Earlier this week I had a post about SunTrust Banks Inc. ending its 93-year investment in the Coca-Cola Co. as emblematic of the closing of a key chapter in the history of 20th century banking. The announcement Nov. 5 that Stifel Financial Corp. will acquire KBW Inc. was a comparable event, at least in my view.

Like most firms, KBW has considered selling before.

When I headed FIG equity research at First Horizon National Corp.'s FTN, we had limited acquisition discussions before and after 9/11. The idea was to combine FTN's fixed-income prowess with KBW's equity prowess. The deal never happened, however. Ten years later, fixed income is performing well across the Street — though the business has too much capacity. The equities business seems to be on a death march.

## **KBW** timeline 1962: Harry Keefe Jr., Gene Bruyette and Norbert Woods found Keefe Bruyette & Woods with five other employees and \$50,000 in capital. 1982: U.S. interest rates peak. 1985: Supreme court ruling in Northeast Bancorp Inc. v. Board of Governors helps open door for regional bank M&A. 1988-1991: Height of S&L crisis in U.S. banking industry. 1998: Bank-sector M&A peaks at 475 deals valued at more 1999: KBW withdraws registration than \$288 billion. statement for an \$85 million IPO ahead of a tumultuous period in which CEO James McDermott would resign ahead of 2000: Firm begins underwriting unfolding scandal. pooled trust preferred securities with FTN Financial. 2001: World Trade Center attack 2002-2005: KBW recovers, with claims the lives of 67 employees. work on some of the largest deals in the FIG space, including Bank of America's landmark deal to acquire MBNA for \$35.7 billion. 2006: KBW completes \$164.2 million IPO. 2007: Bear Stearns hedge funds fail. 2008: KBW begins to take charges for TruPS held on its balance sheet. 2009-2010: KBW participates in the recapitalization of the banking industry, leading and participating in many deals. 2011-2012: Firm faces financial losses and decline in market capitalization. Credit: Holly Bonos Source: SNL Financial

KBW has been synonymous with the banking, trading and research of bank stocks for a half century. KBW grew during the 1960s and turbulent 1970s, and then prospered as banks became growth stocks with the peaking of interest rates, the advent of regional consolidation and the lifting of Depression-era regulatory shackles in the 1980s and 1990s. The exponential growth of the shadow banking system, structured finance and high-priced M&A activity allowed the sector to maintain the "growth" veneer through 2006.

That said, the firm was more than being at the right place at the right time. Most of its employees were highly respected around the Street and among the bankers that ran the firms that KBW sought to conduct business. KBW made money for its clients, which is the most important yardstick on Wall Street.

Media reports are now being filed about the company's storied past, its heroic survival of 9/11, when its ranks were decimated, ill-timed expansions into Europe and Asia and less flattering stories about a couple of past CEOs' personal missteps. Maybe a better epithet is that operating conditions have changed dramatically on Wall Street since 2006, especially for equity- and sector-focused firms such as KBW. If Pimco's "new normal" moniker was transposed from the economy to operating conditions for Wall Street, it would entail lower volumes and less revenue per transaction — be it a trade, underwriting or advisory engagement. After being in the right place with the right people for several decades, KBW was on the wrong side of the Street's new normal. Unlike rival Sandler O'Neill & Partners LP, fixed income is modest, and the unit has been the focus of a rebuilding initiative since some defections occurred in 2011 and 2012. One day the tables will turn and equities will assume the earnings baton from fixed income, but not in time to save KBW and a lot of other small firms that are disappearing.

KBW went public Nov. 8, 2006. The IPO was priced at \$21.00 per share. Timing was spectacular: It occurred a few months before New Century Financial and the Bear Stearns' hedge funds failed, which signaled the beginning of a financial crisis that continues to impact markets and the general economy. KBW reported net income

of \$53 million in 2006, which equated to an ROE of 35.2%. Since then, the company has lost \$26 million on a cumulative basis through Sept. 30. The year-to-date net loss of \$10 million compares to a net loss of \$15 million last year-to-date period. It could have been from virtually any brokerage firm with the key investment banking and commission lines down compared to the prior period. And operating conditions do not seem poised to change anytime soon.

According to SNL Financial, KBW's shares have declined about 17% through Nov. 5 since the IPO, while diversified and opportunistic Stifel's shares have risen 102%. Lehman Brothers, Bear Stearns and others did much worse than sell for a lower price than the IPO, however. The SNL Broker-Dealer index has lost 64% of its value during this period. Further, the KBW name will continue as part of highly respected Stifel, which has successfully navigated the past five years in a way that compares favorably with Jefferies Group Inc., Raymond James Financial Inc. and a handful of commercial banks that grew through

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the crisis.
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