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Regions would be an interesting partner for BB&T or Fifth Third

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While a repeat of 1998 is not going to happen when blockbuster deals such as NationsBank Corp./BankAmerica Corp. and Norwest Corp./Wells Fargo & Co. occurred, 2016 may see a pick-up in M&A among the superregionals. The wind seems to be blowing in that direction. BB&T Corp., KeyCorp and New York Community Bancorp Inc. announced meaningful bank acquisitions this year. M&T Bank Corp. finally got regulatory approval for what I think is a pyrrhic victory to acquire Hudson City Bancorp Inc.

It is not deep thinking on my part to opine that 2016 may see a pick-up of mergers among larger banks, whether structured as a merger of equals or quasi-MOE. Revenue pressure is intense, and massive branch consolidation is the new low hanging fruit to wring costs, in my view. Also, managements (and regulators) seem to be more comfortable navigating the new world regulatory order that Dodd-Frank represents.

Mergers, more so than acquisitions, tend to focus on relative contributions of tangible common equity, core deposits, pretax pre-provision net revenues (PPNR) and the like rather than price in setting the exchange ratio. Expense saves represent the swing factor and raise the question: Who gets credit for them? In a pure MOE, the saves theoretically are shared ratably. In a quasi-MOE in which the lead bank represents 60% to 70% of the pro forma company, the exchange ratio may reflect some lean to the smaller bank in terms of allocating expense saves. Relative negotiating positions, deal competition and the desire to get a deal will determine how much lean.

One other attribute of MOEs and quasi-MOEs is that they usually entail only a modest, if any, acquisition premium. This is why Wall Street's view of MOEs and quasi-MOEs usually runs the gamut of indifference to derision. There is no premium to goose investors' returns to offset the long tail of execution risks.

If mergers are poised to pick up in 2016, I would look to Regions Financial Corp. as a less-obvious candidate than the long discussed (and perhaps inevitable) acquisition targets of Synovus Financial Corp. and First Horizon National Corp. Regions would be an interesting partner in the form of a quasi-MOE with BB&T, or something closer to an MOE with Fifth Third Bancorp. The math is interesting, maybe even compelling, and Regions would deliver a 16-state footprint in the South, Midwest and Texas.

Regions is made of countless banks that, over a couple of decades, were consummated by its four primary legacy companies of Regions, Union Planters Corp., First American Corp. and AmSouth Bancorp. The final deal was a big one. It was a quasi-MOE that was announced May 25, 2006, when Regions and AmSouth joined in a merger that reflected 62% ownership for Regions and 38% for AmSouth. The math went awry, however.

The slide deck that accompanied the announcement included projected pro forma 2008 net income of $2.2 billion, or $3.19 per share. In the latest 12 months (LTM) ended Sept. 30, Regions' net income available to common shareholders was $929 million and EPS was 69 cents. Profitability is OK, not great. LTM ROA and ROTCE are 0.82% and 8.7%. Of course, who in 2006 would have predicted a NIM in 2015 that is close to 3% due to seven years of ZIRP? Not me. Per-share comparisons are hampered by the amount of capital Regions had to raise in the aftermath of the crisis. Its share count increased 104% to 1.4 billion by year-end 2012 from 694 million at year-end 2007. Buybacks have since reduced the share count by about 8%.

As of Sept. 30, the company reported total assets of $125 billion, which makes Regions the 24th-largest U.S. bank or thrift according to a ranking by SNL. BB&T, with $218 billion of assets, is 12th; Fifth Third is 17th. The math is interesting because it appears to me BB&T could afford a reasonable premium and still capture accretion from the expense saves.

Here is the simplistic math. Regions' LTM PPNR was about $1.8 billion, according to SNL, compared to $3.7 billion for BB&T. The relative ownership based upon this one dimensional snapshot would be 32% Regions, 68% BB&T. Assuming 30% expense saves, Regions' pro forma LTM PPNR would be $2.8 billion, which would imply relative ownership of roughly 43%. To state the obvious, BB&T would never agree to an exchange ratio that would give Regions' shareholders all the benefit and its shareholders all of the execution risk. But maybe some credit to Regions could produce a win-win deal.

For example, if the exchange ratio was 0.336 of a BB&T share for each Regions share, Regions' shareholders would own about 36% of the pro forma BB&T. Based upon BB&T's closing price of $38.66 per share on Nov. 27, the exchange ratio would imply $13.00 per share of value to Regions, or a 28% premium to Regions' closing price of $10.17 per share. It would also equate to 18.8x LTM EPS and 153% of tangible book value per share as of Sept. 30. Before you sneer at the valuation, nearly 19x earnings with little credit costs embedded is pretty good, in my view. What appears to be a modest tangible book value multiple is a function of the company's modest ROATCE.

Another benefit for Regions shareholders would be a pick-up in the per share dividend. An exchange ratio of 0.336 would produce an increase of about 50% in the annualized quarterly dividend to 36 cents from 24 cents given BB&T's current annualized quarterly dividend of $1.08 per share. Regions' annualized quarterly dividend peaked at $1.52 per share in the second quarter of 2008; it was later cut to 1 cent per quarter as the financial crisis unfolded.

The math for Fifth Third is similar, but not as compelling because a combination with Fifth Third would be more akin to an MOE with ownership of about 42% for Regions based upon LTM PPNR before any expense saving credits. Also, Fifth Third trades at a pedestrian multiple of just 12.4x LTM EPS and 136% of tangible book value per share based upon its closing price on Nov. 27. (BB&T's comparable multiples were 14.4x and 196%.) It appears the math with Fifth Third would support a low premium deal of less than 10%. Wall Street would give a Bronx cheer for that unless BB&T was not interested or Regions current modest upward trajectory was poised to turn down. That said, Fifth Third's Midwest-centric franchise combined with Regions' Southeast-centric franchise would not be an illogical combination, provided management could execute.

Would Regions' board agree to a deal along the lines of the one out outlined with BB&T? I do not know, but it makes good fodder for what-if discussions. Likewise, what-if analyses of the past make for good discussions, but the past cannot be changed. The closing price for Regions on May 22, 2006, a couple of days before the AmSouth deal was announced, was $35.68 per share; AmSouth's closing price was $28.53 per share, or virtually the same as the deal price at announcement based upon the exchange ratio of 0.7974 of a Regions share per AmSouth share. It was a no-premium deal that made sense at the time absent a bank like JPMorgan Chase & Co. acquiring one of the two. Unfortunately, the bottom fell out two years later. Regions has been playing catch-up since. If a meaningful premium deal became available, shareholders might question why it would forego the short-term gain for an uncertain long-term plan.

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