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Signature Bank, value stocks that are not a value and growth stocks that do not grow

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When reviewing Regions Financial Corp.'s and Synovus Financial Corp.'s fourth-quarter and fiscal 2013 results on Tuesday, I thought of a quip a colleague had quoted to me before the financial crisis: "value stocks are no value and growth stocks are not growing." Regions' and Synovus' results qualitatively were not very different from most of their regional bank peers, though I was amused that the "Key Ratios" table from Regions' abbreviated wire release listed metrics such as NIM, Tier 1 capital, net charge-offs and the like, but not ROA, ROE and ROTCE.

In fairness to Regions, I think the company's strategic position is better than the Street may realize because its key legacy markets of Georgia, Florida and middle Tennessee are returning to their traditional growth modes while Louisiana's energy sector performs very well. Also, Alabama has been an under-rated banking market forever by most on Wall Street.

Even Dallas-based Comerica Inc. had flat trends beneath the surface. Before a subsequent event related to a litigation settlement reduced EPS by 15 cents per share, the company reported fourth-quarter EPS of 77 cents per share, up 13.2% from 68 cents per share in the year-ago quarter; however, net interest income rose less than 2% to $430 million and fee income was unchanged at $204 million. A reduction in the loan loss provision expense, tax rate and average shares accounted for most of the year-over-year increase in EPS before the restatement occurred. While many banks are still grappling with declining loan yields, Comerica seems to be near an inflection point given relative stability in the commercial portfolio loan yield the past few quarters (3.26% in the fourth quarter).

Or maybe that is not quite true since a commercial loan priced at 30-day LIBOR plus 250 bps would yield less than 3%, assuming no LIBOR floor. Management offered this guidance for 2014 net interest income — "net interest income modestly lower, reflecting a decrease in purchase accounting accretion, to $10 million to $20 million, and the effect of a continued low rate environment, partially offset by loan growth." Guidance sounds like more of the same to me — flat at best until short rates increase and push the NIM and EPS higher.

In a more normal market environment absent aggressive bond buying by the central bank, acceleration (or deceleration) in EPS growth, an inflection in the credit cycle and/or shifts in Fed policy would drive meaningful moves in bank stocks. We did not experience any of those in 2013, though most bank indices moderately outperformed the 31.9% total return the S&P 500 posted. In my view, taper was not meaningful for bank earnings. Although the yield curve is steeper, most commercial banks borrow and lend at the short end of the curve. That the MBS portfolio can be reinvested at better yields is not a big earnings factor like accelerating loan growth and rising LIBOR would prove to be. In fact, I could argue it was somewhat negative for commercial banks because the steepening of the yield curve that occurred during the summer caused mortgage originations, mortgage gains and big unrealized gains in bond portfolios to plummet.

So the flattish results recorded by most banks can be contrasted with a handful of banks that are growth stocks. Although I should not have been surprised, Signature Bank smashed estimates again, as it does most quarters, by reporting fourth-quarter earnings of $1.34 per share, up 27.6% over the year-ago quarter. Consensus was $1.27 per share. Net interest income rose 21.1%, paced by loan growth of 38.4%, which was partially offset by a 21-basis point reduction in the NIM to 3.32%. The Street was surprised by the strength of the quarter, judging by the 11.0% increase in the shares during January 21 and 22.

Signature's model of focusing on core deposits and hiring established lending teams is not unique, though execution has been uniquely good since the company was founded in 2001. And great execution in a massive market (Manhattan and the Greater New York) where market share can be taken from lumbering large banks is a recipe for sustained high growth, though at some point the law of large numbers will catch up with the growth rate and presumably the valuation.

The performance reminds me of a money maker from the 2000's: Alabama National BanCorp.'s Alabama National had a cult-like following for years because management executed a focused business model in growth markets (Alabama's MSAs, Atlanta and select Florida MSAs) in which the company gained share from large regionals in fast growing markets. Alabama National also had units that focused on mortgage banking, bond sales to correspondent banks and specialty finance. The model and superb execution drove strong growth, good profitability and share performance for years. Management later had the sense to sell the company in 2007 as collateral values began to fall. Signature is doing the same, but its market is much larger. Also, Signature has made a push with a specialty finance lending unit that accounted for about $200 million of $1.4 billion of loan growth recorded in the quarter — something I believe that more banks will have to do drive loan growth given tepid demand in many markets.

Signature is not the only growth story in the sector. Pinnacle Financial Partners Inc. posted a 29.4% increase in fourth-quarter EPS to 44 cents per share. Revenues rose 7.7% primarily as a result of 11.6% loan growth. Pinnacle's model is similar to Signature's in which the company is growing market share in growth markets (Nashville and Knoxville) by hiring top talent. Stabilization of the NIM around the current 3.70% (3.70%-3.80% guidance) implies revenue growth could accelerate if loan growth in 2014 is comparable to 2013. Pinnacle's shares rose 7.3% on January 22, the day of the release.

One of the other releases that points to a bright outlook is Renasant Corp. There are a number of small regionals whose operating models are similar to Renasant in which strategic acquisitions offer the opportunity to leverage cost structures and build market share in attractive markets. Renasant reported EPS of 36 cents per share (40 cents per share excluding merger charges), compared to 29 cents per share in the year-ago quarter.

So in an industry that looks like a utility with little growth and lots of regulation, are the stocks expensive? The no/little growth group of Regions, Comerica and Synovus trade for 12.9x, 16.4x and 18.7x consensus full-year 2014 EPS, based upon the closing price on January 22. This compares to 17.2x, 17.4x and 23.2x for Pinnacle, Renasant and Signature. Regions appears to be a value stock at less than 13x earnings, but Regions has not been an EPS growth story. EPS was $2.67 per share in 2006, versus 77 cents per share in 2013 — though the comparison is overstated because the post-crisis capital raises have boosted the share count to 1.38 billion share from 730 million at year-end 2006.

David Ellison, a portfolio manager with Hennessey Funds, offered a piece of advice from Peter Lynch, his old boss at Fidelity from 30 years ago, during an interview with Bloomberg Radio. The gist from Peter Lynch was to own the stock if the business is getting better and not worry about valuation. Signature, Renasant and Pinnacle all outperformed over the past year, producing total returns of 71.4%, 65.5% and 63.1%, respectively.

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