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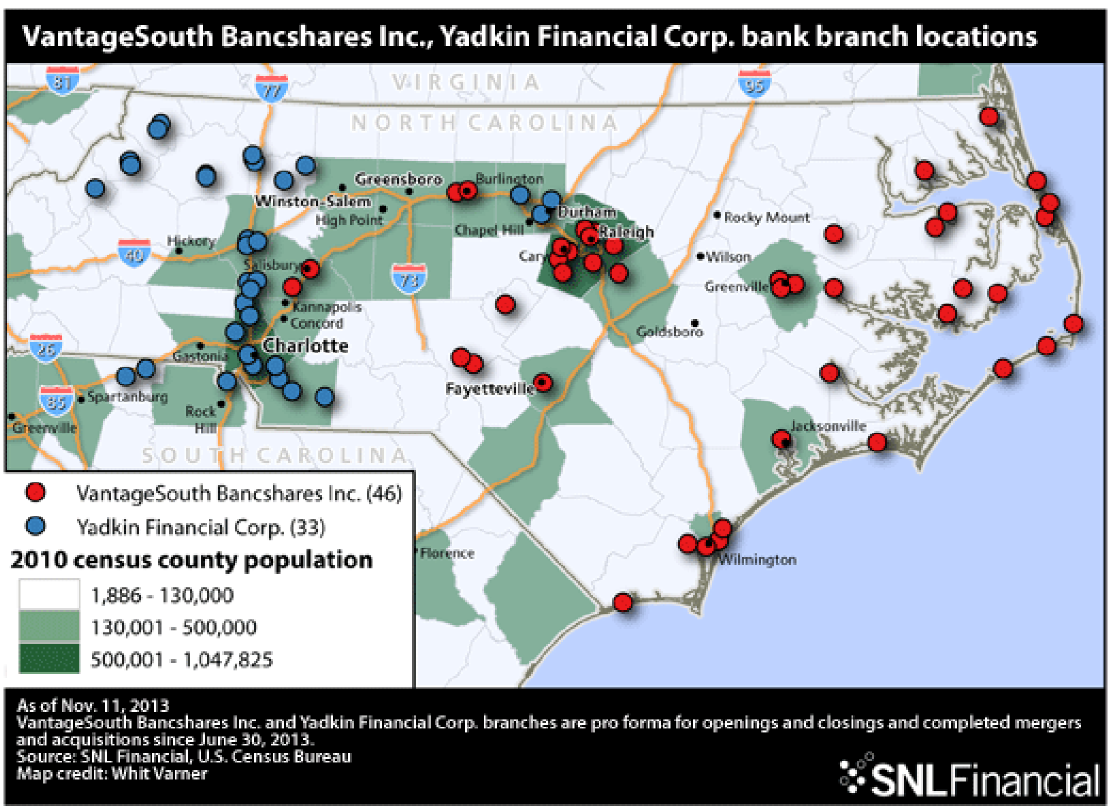
Yadkin Financial could be a regional stepping stone

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.

As SNL noted on November 6, press reports have Raleigh, N.C.-based VantageSouth Bancshares Inc. in discussions to acquire Elkin, N.C.-based Yadkin Financial Corp. If a transaction occurs, it has the look of being a quasi-MOE among two similar-sized institutions, though presumably private-equity backed VantageSouth would be the senior partner. Such a deal would be similar to what has occurred in the banking sector over the past two years: a troubled bank such as Yadkin is recapitalized, cleansed of its problem assets and then later sold to a bank that is focused on leveraging capital and improving its franchise through strategic acquisitions.

As shown in the table and SNL branch map, the two companies appear to be a good fit on paper. A deal would join Yadkin's Charlotte, N.C., and I-77 corridor-focused footprint with Vantage's Raleigh and eastern Carolina franchise. For those that remember, the pro forma organization looks like First Charter, but with the franchise moving to the east from Charlotte rather than to the west to Asheville, N.C. Key metrics such as loans, deposits, tangible common equity, revenues and pretax, pre-provision operating income imply roughly equal contributions by each to a pro-forma organization. Maybe the exchange ratio — assuming an all-stock financed deal — would approximate 3.0 Vantage shares (or more) for each Yadkin share to produce a roughly 50-50 ownership?



VantageSouth's most recent capital action has been the filing of an S-1 to issue $57.5 million of noncumulative preferred ($50 million excluding the underwriting shoe) to fund the redemption of $43 million of TARP preferred and a $2 million warrant held by Treasury. I assume the pending issue could be upped to add a cash component for Yadkin and/or to fund the redemption of Yadkin's $28 million of Series T preferred stock because the coupon for the two issues will reset to 9% from 5% in February and August 2014. VantageSouth Bank's parent company is lightly levered with $8 million of trust preferred and $38 million of subordinated debt. The addition of Yadkin's subsidiary bank, Yadkin Bank, would materially improve the upstream dividend capacity of VantageSouth Bank to fund the parent company's debt service, preferred dividends and maybe the initiation of a modest common dividend.

VantageSouth's management has not let any grass grow under its feet since Piedmont Community Bank Holdings Inc., the 70% majority owner of VantageSouth, was capitalized in 2010. Yadkin would be the fifth deal. The investor presentation material notes that management has collectively consolidated 25 banks over the past 30 years. The economic rationale to acquire Yadkin should entail: (a) expense savings to produce operating leverage and an ROA that is closer to the 1.0% target than has been realized to date; (b) better organic revenue potential with a larger Charlotte presence; and (c) a more attractive franchise if Piedmont eventually elects to sell VantageSouth — though an all-stock deal would substantially reduce Piedmont's ownership.

Also, the ability to acquire should improve to the extent a deal for Yadkin produces a bigger market cap and greater share liquidity. Further, Wall Street has been agreeable to moderately priced deals the past couple of years such that many acquirers' valuations have improved with deal announcements. I believe this is the case because the Street is rewarding growth in a stagnant operating environment. And higher valuations allow acquirers to more easily meet sellers' pricing expectations in the next deal in a "use-it-or-lose it" proposition.

I do not know what the thought process at Yadkin is about remaining independent, but it appears more than one-third of its 14.4 million shares were issued to institutional shareholders in September 2012 when Yadkin raised $45 million of new common equity; it also converted $21 million of TARP to common equity. With the shares closing at $17.13 per share on Nov. 8, the investors who funded the recap have roughly doubled their money in a year given the $8.40 per share issue price as adjusted for the May 2013 one-for-three stock split. No one goes broke taking a profit — especially a double in a bank.

And while selling to a larger bank holding company with a more liquid currency might be preferable for these investors, it might not be an option today. One of the aspects of the post-crisis M&A market is the lack of regional banks that are in acquisition mode. Union Planters Corp. may have been viewed as the buyer of last resort by many small banks prior to its merger with Regions Financial Corp. in 2004, but as a large bank holding company with NYSE-listed shares, shareholders who received large amounts of shares could quickly unload them; that is not necessarily the case with VantageSouth and other similar-sized acquirers. Perhaps the closest regional bank to Yadkin that is acquisitive is First Financial Holdings Inc. — however, management has indicated that it is focused on integrating recent deals before returning to M&A. There are several North Carolina-based banks that are about the same size as Yadkin (and VantageSouth) that might figure into Yadkin's calculus if the board is ready to sell, including Park Sterling Corp. and possibly Capital Bank Financial Corp.

Yadkin Financial Corp. and potential suitors

			Pro forma Yadkin Financial-VantageSouth				
	Yadkin Financial Corp.	VantageSouth Bancshares Inc.	Total	Yadkin contribution (%)	VantageSouth contribution (%)	Park Sterling Corp.	First Financial Holdings Inc.
Ticker	YDKN	VSB				PSTB	SCBT
Closing price ($)	17.13	5.15				6.62	62.48
Market capitalization ($M)	247.8	244.5	492.3	50.34	49.66	286.9	1,327.5
Price/tangible book (%)	167.01	156.67				127.93	253.51
Price/LTM core EPS (x)	NM	24.56				17.37	17.52
Total assets ($000)	1,813,517	2,046,071	3,859,588	46.99	53.01	1,940,060	8,028,441
Gross loans held for investment ($000)	1,333,437	1,353,360	2,686,797	49.63	50.37	1,316,342	5,754,345
Total deposits ($000)	1,491,336	1,622,539	3,113,875	47.89	52.11	1,555,963	6,663,106
Trust preferred (FAS 150) ($000)	35,000	5,544	40,544	86.33	13.67	15,037	NA
Total preferred equity ($000)	28,339	42,609	70,948	39.94	60.06	0	65,000
Tangible common equity ($000)	148,400	156,033	304,433	48.75	51.25	224,278	523,651
Tang common equity/ tang assets (%)	8.19	7.75				11.78	6.85
Total revenue ($000)	21,517	24,443	45,960	46.82	53.18	21,571	94,936
Total noninterest expense ($000)	13,996	18,205	32,201	43.46	56.54	15,503	65,022
Non-FTE preprovision net revenue ($000)	6,958	6,238	13,196	52.73	47.27	6,068	29,914
Provision for loan losses ($000)	40	1,280	1,320	3.03	96.97	-419	659
Net income before taxes ($000)	7,327	4,481	11,808	62.05	37.95	6,320	18,858
Net income after taxes ($000)	4,711	1,484	6,195	76.05	23.95	4,214	12,054
Core ROAA (%)	1.02	0.36				0.91	1.11
Core ROAE (%)	10.42	3.10				6.43	9.53
Net interest margin (%)	3.96	4.43				4.19	5.10
Efficiency ratio (%)	64.38	73.65				70.02	66.66
Reported nonperforming assets ($000)	20,864	30,717	51,581	40.45	59.55	29,543	66,145
NPAs & 90+ PD/loans & REO (%)	2.73	2.28				1.87	NA

Pricing data as of Nov. 8, 2013.
NM = not meaningful
NA = not available
Financial performance metrics are at or for the quarter ended Sept. 30, 2013.
Source: SNL Financial

In any event, the Carolinas have been an area that private equity and institutional investors have made a bet on given attractive demographics and the need for consolidation. Yadkin may be a stepping stone in the process.

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 or 615.345.0350.