

# Bank Watch



**August 2015**

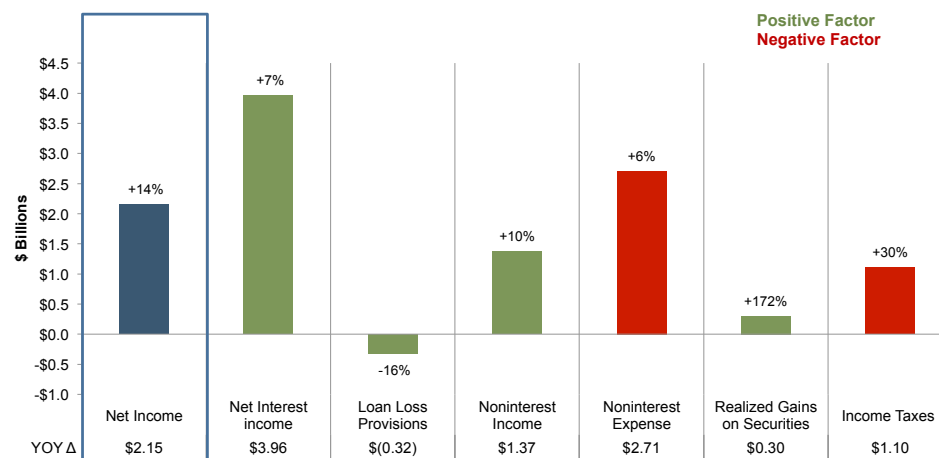
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# Bank Watch

## Strategic Planning for Community Banks on the Mend

Despite much commentary about the significant economic and regulatory headwinds impacting community banks, profitability is on the mend. Community bank earnings improved in the trailing twelve months ended June 30, 2015 with net income up 14% to \$17.6 billion compared to \$15.5 billion in the twelve months ended June 30, 2014.<sup>1</sup> Nearly 60% of community banks reported higher profitability based upon annualized first half 2015 net income compared to 2014 levels. The number of unprofitable banks also declined to 41 in the second quarter of 2015, compared to 109 in 2014 and 167 in 2013. The median return on assets (ROA) for community banks was up to 0.96% (annualized based upon the first half of 2015), which was the highest level since 2008.

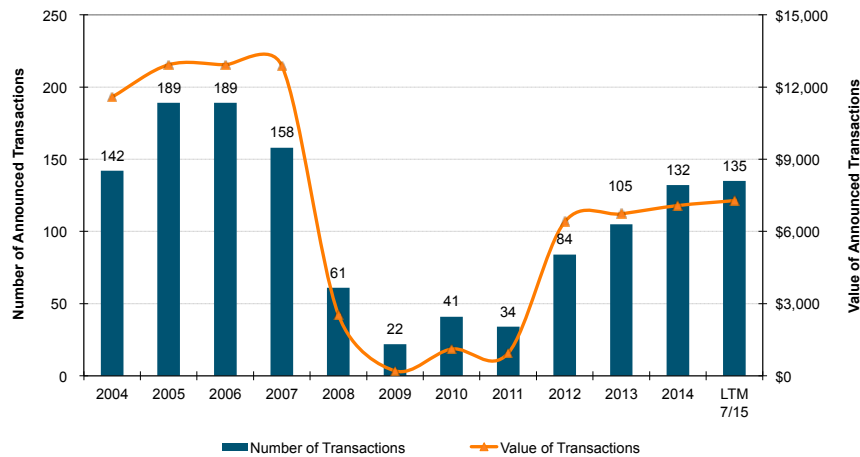
**Figure 1: Community Bank Contributions to Year-Over-Year Net Income Change**



<sup>1</sup> Community bank group discussed herein includes 3,655 commercial banks in the United States with assets between \$100 million and \$5 billion, excluding those with unusual loan portfolio and revenue composition based on data compiled from SNL Financial.

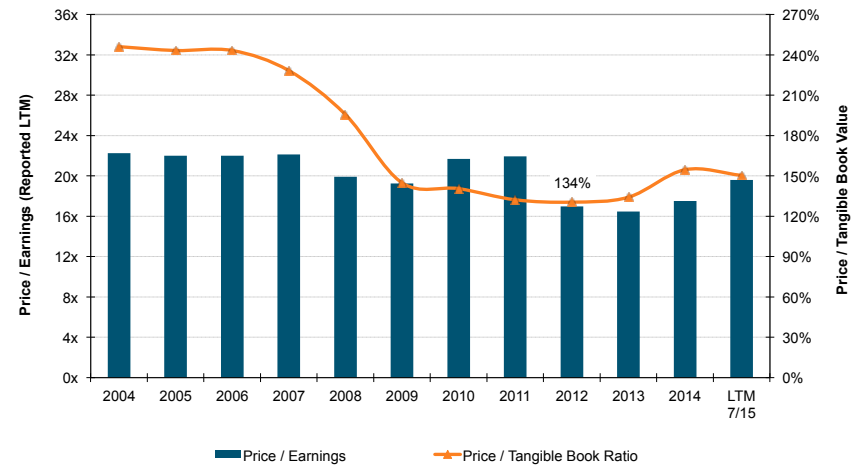
**Figure 2: Community Bank Deal Activity Overview: Transactions**

Banks with Assets < \$5 Billion and LTM ROE > 5%



**Figure 3: Community Bank Deal Activity Overview: P/E & P/TBV Multiples**

Banks with Assets < \$5 Billion and LTM ROE > 5%



As detailed in Figure 1, key contributors to improving earnings were higher net interest income and lower loan loss provisions. Loan growth drove the improvement in net interest income as 84% of community banks reported loan growth in the trailing twelve month period, with the median community bank's loan growth rate reported at 7.2%. Loan growth offset net interest margin ("NIM") compression as NIMs were at their lowest level over the 10-year historical period. As the Federal Reserve's zero-interest rate policy ("ZIRP") grinds on, asset yields continue to compress while funding costs have essentially reached a floor. One interesting item to gauge in future quarters is how much interest rate and credit risk is being taken by community banks to grow loans and earnings.

Another sign of improving community bank health is that deal activity is up from recent prior periods as shown in Figure 2. Price/earnings multiples have also improved in recent periods (Figure 3) and appear to be relatively in line with long-term trends at approximately 20x. Price/tangible book multiples are still below longer-term trends, largely reflecting that although

improved from the Great Recession returns on assets and equity remain below pre-financial crisis levels.

While it is difficult to tell whether community bank earnings have peaked and how long this cycle may last, improving profitability expands the strategic options available to community banks. A recent [article](#) by SNL Financial noted that a number of community banks are looking to sell as earnings may have plateaued. While selling is one option available to community banks in this environment, the range of strategic options available is much broader than that. A well-rounded strategic planning session should include an assessment of the bank's unique strengths, weaknesses, and opportunities as well as a review of the bank's performance and outlook relative to both its history and peers. Then, a broader discussion of a range of options that can deliver growth and enhance shareholder value should be discussed. Those other options could include organic and/or acquisitive growth and other ways to provide liquidity and enhance returns to shareholders

such as special dividends, share repurchases, management buy-outs, and employee stock ownership plans.

Founded in 1982, in the midst of and in response to a previous crisis affecting the financial services industry, Mercer Capital has witnessed the industry's cycles. Despite industry cycles, Mercer Capital's approach has remained the same – understanding key factors driving the industry, identifying the impact of industry trends on our clients, and delivering a reasoned and supported analysis in light of industry and client specific trends.

Mercer Capital has experience facilitating strategic planning sessions for community banks and providing a broad range of specialized advisory services to the sector. Contact us to discuss scheduling a strategic planning session or your institution's specific needs in confidence.



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## What We're Reading

Jack Milligan of *Bank Director* examines "What Makes a Great Bank CEO" and notes the importance of understanding how technology impacts customers.

<http://mer.cr/1Tw9K3j>

Jeff Gerrish of Gerrish McCreary Smith has an interesting article entitled "Ignore Defeatist Talk, Community Bankers."

<http://mer.cr/1Mq7YMU>

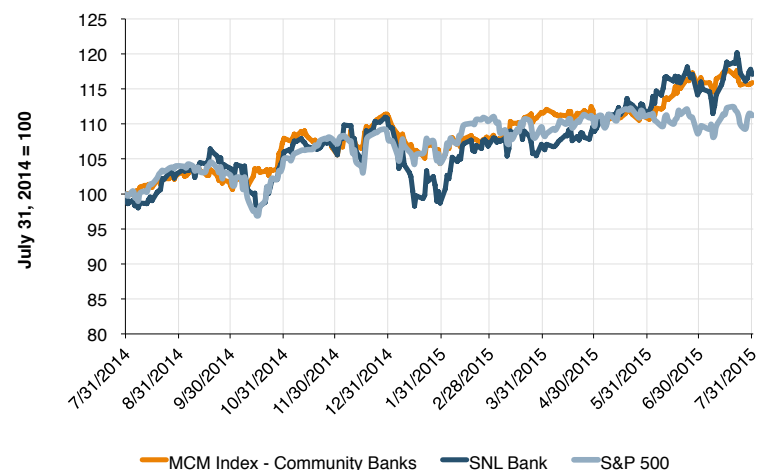
Brian Graham of Alliance Partners discusses "How Community Banks Can Grow Loans by Partnering with Competitors."

<http://mer.cr/1IKQ43i>

Nathan Stovall of SNL Financial had an interesting piece entitled "Small Banks Taking M&A Plunge as Earnings Plateau." (Subscription required.)

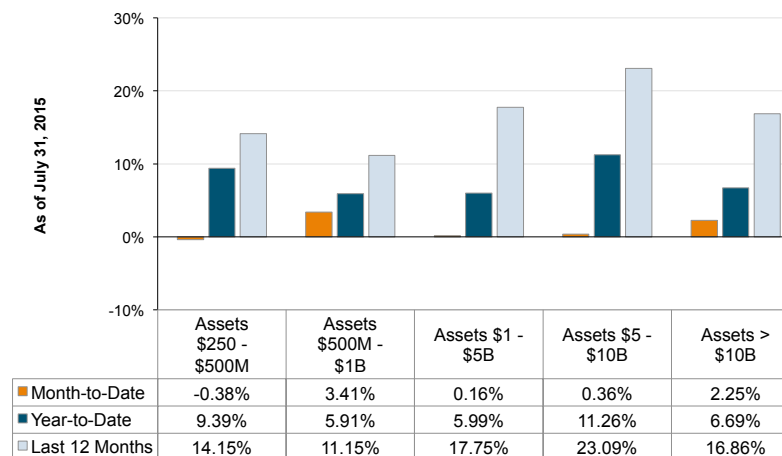
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Mercer Capital's Bank Group Index Overview



Return Stratification of U.S. Banks

by Asset Size

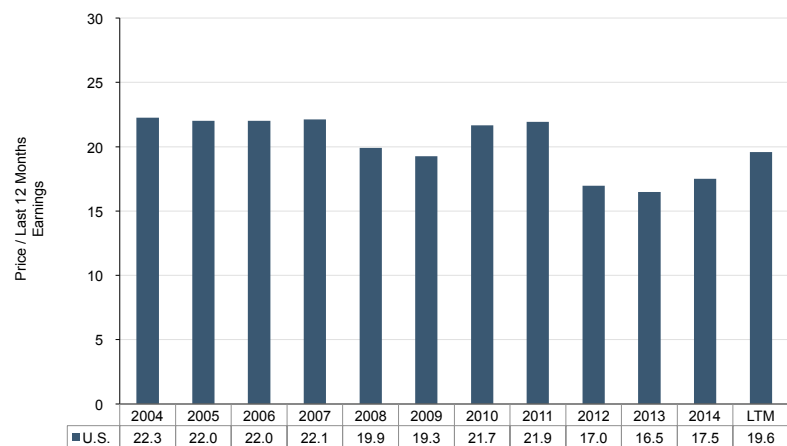


Median Valuation Multiples

Indices	Median Total Return			Median Valuation Multiples as of July 31, 2015					
	Month-to-Date	Year-to-Date	Last 12 Months	Price / LTM EPS	Price / 2015 (E) EPS	Price / 2016 (E) EPS	Price / Book Value	Price / Tangible Book Value	Dividend Yield
Atlantic Coast Index	1.18%	6.15%	18.89%	15.66	15.46	13.19	104.4%	109.8%	2.2%
Midwest Index	-0.82%	5.57%	17.81%	14.76	14.62	12.32	118.4%	128.6%	2.3%
Northeast Index	-0.45%	1.54%	10.63%	14.50	14.49	13.17	116.3%	128.6%	3.0%
Southeast Index	-1.50%	4.64%	19.84%	12.59	14.75	13.14	105.7%	116.6%	1.9%
West Index	2.16%	6.26%	15.51%	15.72	15.99	13.69	117.6%	124.9%	2.6%
Community Bank Index	0.00%	4.45%	15.90%	14.85	14.94	13.08	113.1%	123.8%	2.5%
<b>SNL Bank Index</b>	<b>2.11%</b>	<b>6.83%</b>	<b>17.09%</b>						

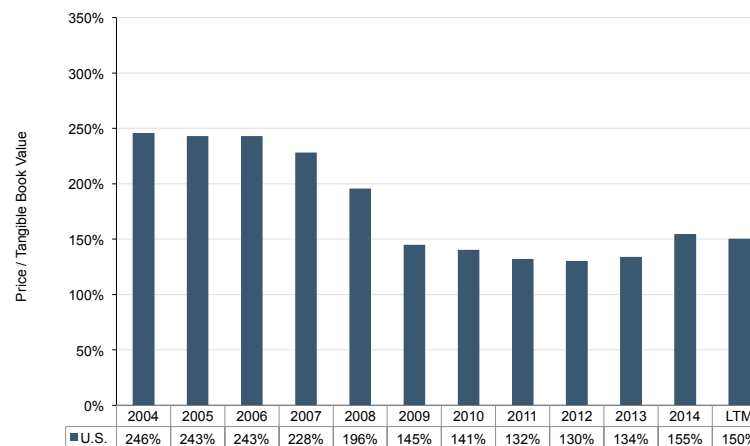
### Median Price/Earnings Multiples

Target Banks' Assets <\$5B and LTM ROE >5%



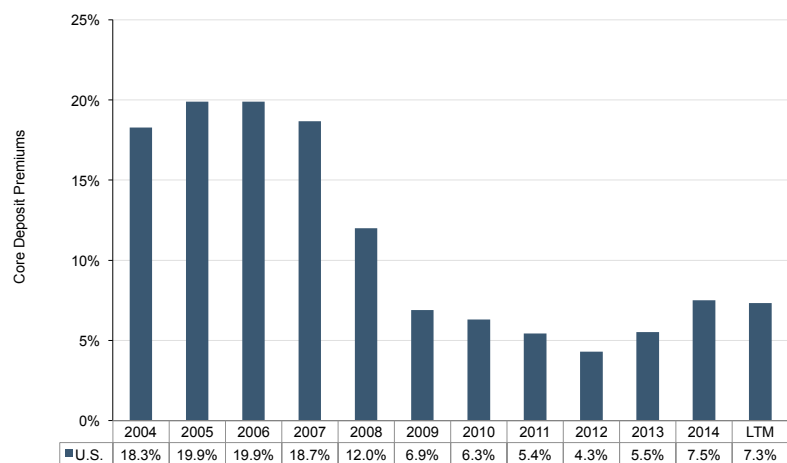
### Median Price/Tangible Book Value Multiples

Target Banks' Assets <\$5B and LTM ROE >5%



### Median Core Deposit Multiples

Target Banks' Assets <\$5B and LTM ROE >5%



### Median Valuation Multiples for M&A Deals

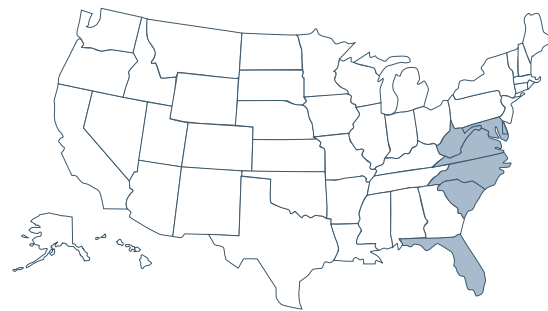
Target Banks' Assets <\$5B and LTM ROE >5%, 12 months ended July 2015

Regions	Price / LTM Earnings	Price / Tang. BV	Price / Core Dep Premium	No. of Deals	Median Deal Value	Target's Median Assets	Target's Median LTM ROAE (%)
Atlantic Coast	21.89	1.61	7.7%	14	71.16	479,979	7.38%
Midwest	17.69	1.55	7.3%	69	33.55	104,786	8.77%
Northeast	20.03	1.67	9.5%	5	126.00	492,002	6.69%
Southeast	17.85	1.40	6.1%	30	29.82	186,921	8.15%
West	20.13	1.48	7.4%	17	58.98	253,143	9.16%
<b>Nat'l Community Banks</b>	<b>19.59</b>	<b>1.50</b>	<b>7.3%</b>	<b>135</b>	<b>41.92</b>	<b>179,459</b>	<b>8.29%</b>

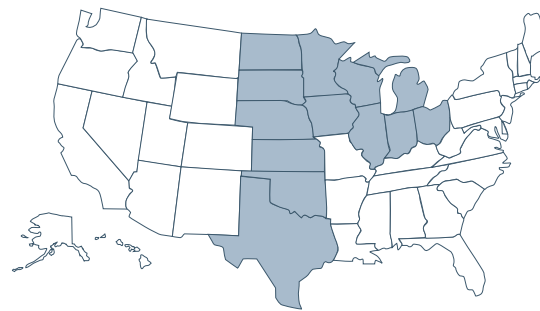
Source: Per SNL Financial

# Mercer Capital's Regional Public Bank Peer Reports

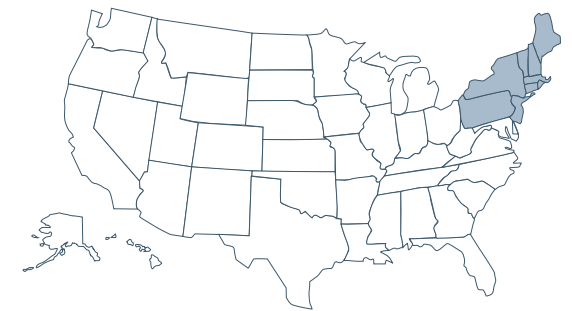
Updated weekly, Mercer Capital's Regional Public Bank Peer Reports offer a closer look at the market pricing and performance of publicly traded banks in the states of five U.S. regions. Click on the map to view the reports from the representative region.



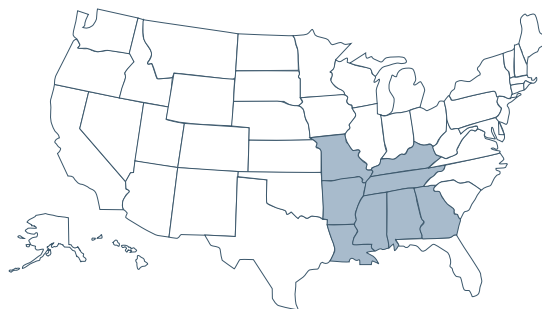
**Atlantic Coast**



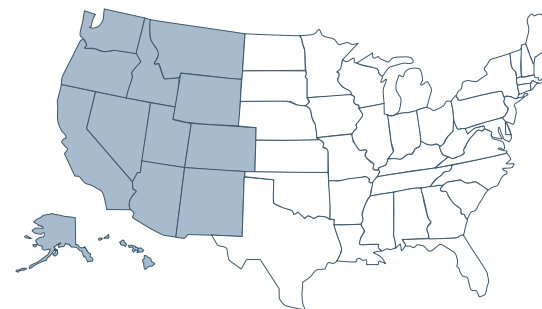
**Midwest**



**Northeast**



**Southeast**



**West**

# Mercer Capital

Financial Institutions Services

Mercer Capital assists banks, thrifts, and credit unions with significant corporate valuation requirements, transactional advisory services, and other strategic decisions.

Mercer Capital pairs analytical rigor with industry knowledge to deliver unique insight into issues facing banks. These insights underpin the valuation analyses that are at the heart of Mercer Capital's services to depository institutions.

- » Bank valuation
- » Financial reporting for banks
- » Goodwill impairment
- » Litigation support
- » Loan portfolio valuation
- » Tax compliance
- » Transaction advisory
- » Strategic planning

Mercer Capital is a thought-leader among valuation firms in the banking industry. In addition to scores of articles and books, *The ESOP Handbook for Banks*, *Acquiring a Failed Bank*, *The Bank Director's Valuation Handbook*, and *Valuing Financial Institutions*, Mercer Capital professionals speak at industry and educational conferences.

For more information about Mercer Capital, visit [www.mercercapital.com](http://www.mercercapital.com).

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# Erickson Partners Merges with Mercer Capital



**Mercer Capital**, a national business valuation and financial advisory firm specializing in Corporate Valuation, Litigation Support, Financial Reporting Valuation, and Transaction Advisory Consulting, and **Erickson Partners, Inc.**, a Texas-based Valuation and Litigation Support firm, announce their merger effective July 1, 2015.

Mercer Capital, with its strong presence throughout the Southeast and Midwest, and Erickson Partners, with its strong presence in Texas and Oklahoma, are a perfect fit.

Both firms maintain the highest standards of quality for financial analysis and client service and believe deeply in hiring and developing the best professionals.

“The culture of both firms is so similar and that was important to us. The professionals of Erickson Partners are well-known in the valuation profession as some of the best and brightest. Their work product and reputation are stellar. This merger not only allows us to broaden our geographic reach but also our industry expertise,” said **Matt Crow**, President of Mercer Capital.

Erickson Partners enhances Mercer Capital’s broad base of industry concentrations with their exceptional history working with and knowledge of professional sports franchises and the energy sector.

“Over our 30 plus year history, Mercer Capital has developed several industry concentrations. By adding the knowledge, insight, and expertise of Don Erickson, Bryce Erickson, and the rest of the professionals of Erickson Partners, we now bring deep experience and insight to a broader range of industries than we could as separate firms,” said **Chris Mercer**, CEO of Mercer Capital.

“Combining with Mercer Capital, we will now be able to offer new or expanded services that complement our existing services, as well as additional industry expertise,” said **Bryce Erickson**, Managing

Director of Erickson Partners. “In addition to our sports franchise and energy industry concentrations, we will be able to offer deep industry concentrations in construction and building materials, agribusiness, manufacturing and financial institutions, which includes depository institutions, insurance companies, fintech companies, asset management firms, and PE firms.”

“The combined firm will have over 40 valuation professionals positioned in five markets throughout the southwest and southeast. Such a deep bench will provide us with a tremendous opportunity to better serve the expanding needs of our clients,” said **Don Erickson**, President of Erickson Partners. “Joining with Mercer Capital gives us national resources that will benefit our clients in Texas and beyond.”

## About Mercer Capital

Mercer Capital is a national business valuation and financial advisory firm offering corporate valuation, litigation support, financial reporting valuation, and transaction advisory consulting services to a national client base. Clients include private and public operating companies, financial institutions, asset holding companies, high-net worth families, and private equity/hedge funds.

## About Erickson Partners, Inc.

Erickson Partners is a professional valuation and advisory firm specializing in business valuation, litigation support, financial investigations and strategic corporate advisory services. Founded by Don & Bryce Erickson, Erickson Partners has served large and small clients by providing complex financial and economic analysis, leading to reasonable valuation opinions that withstand scrutiny.

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