Bank Watch

February 2017

New Book for Community Bankers
Coming Spring 2017

See Page 6 for More Information

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2016 and 2017:
Buy the Rumor and Sell the News?

Last year was a volatile year for credit and equity markets that saw price moves that more typically play out over a couple of years. The year began with a broad-based sell-off in risk assets that got underway in late 2015 due to concerns about the impact of the then Fed intention to raise short-term rates up to four times, widening credit spreads, and a collapse in oil prices. Credit (i.e., leverage loans and high yield debt) and equities rebounded in March and through the second quarter after market participants concluded that media headlines about potentially sub $20 oil were ridiculous and that the Fed probably would not raise rates four times; or, stated differently—the U.S. economy was not headed for recession. Markets staged the second strong rally of the year immediately following the national elections on November 8th with the surprise election of Donald Trump as the next POTUS, and Republicans holding Congress.

Not surprisingly, the heavily regulated financial sector outperformed the broader market, with bank stocks (as represented by the SNL U.S. Bank Index) gaining 23% versus 5% for the S&P from November 8th through the end of the year. Most of the return for the bank index was realized after the election given the full year total return of 26%. Banks in the $1 to $5 billion and $5 to $10 billion groups led the way in 2016 with total returns on the order of 44% for the year (Figures 1-2).

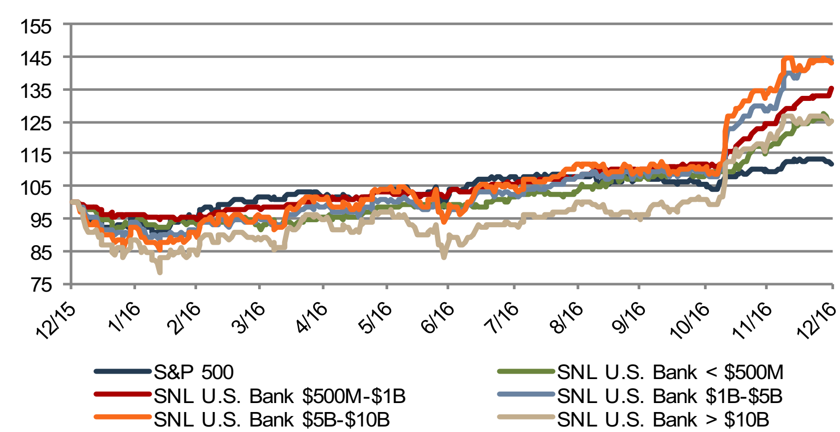
The magnitude of the rally in bank stocks was notable because the U.S. economy was not emerging from recession – when bank earnings are near a cyclical trough, poised to turn sharply higher as credit costs fall and loan demand improves.

Figure 1: 2016 Performance

Index	Total Return
S&P 500	12.0%
SNL U.S. Bank	26.4%
SNL U.S. Bank < $500M	25.0%
SNL U.S. Bank $500M-$1B	35.0%
SNL U.S. Bank $1B-$5B	43.9%
SNL U.S. Bank $5B-$10B	43.3%
SNL U.S. Bank > $10B	24.9%

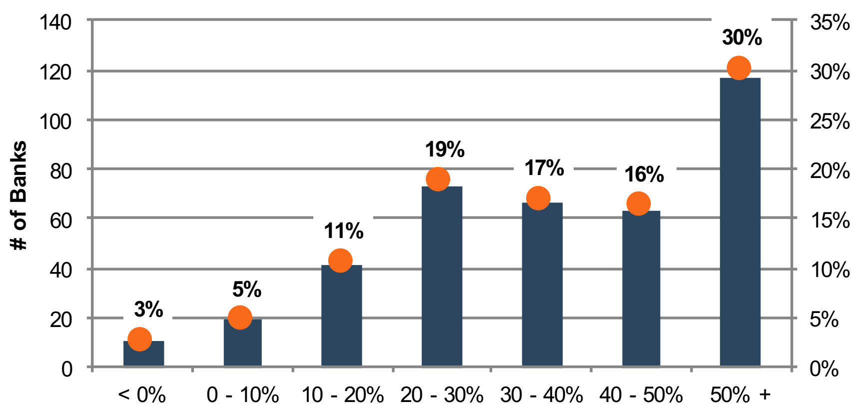
Source: S&P Global Market Intelligence

Figure 2: Total Returns



Source: S&P Global Market Intelligence

Figure 3: Total Returns



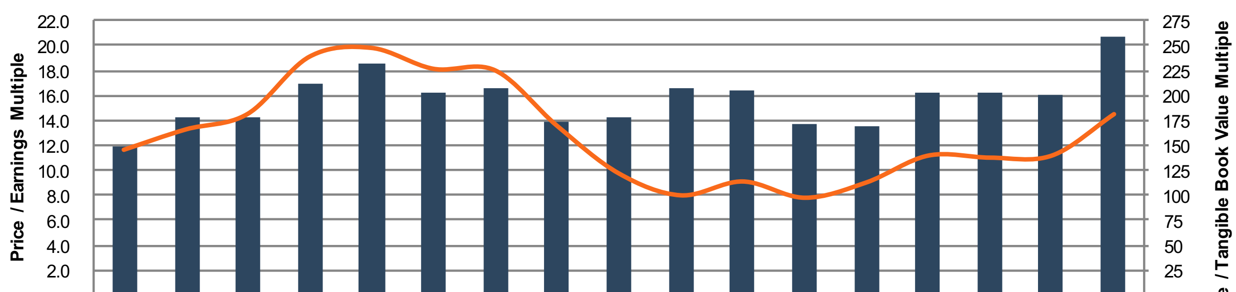
Source: S&P Global Market Intelligence

Last year was a great year for most bank stock investors. Bank returns averaged around 40% in 2016, with 30% of the U.S. banks analyzed (traded on the NASDAQ, NYSE, or NYSE Market exchanges for the full year) realizing total returns greater than 50%. The returns reflected three factors: earnings growth, dividends (or share repurchases that were accretive to EPS), and multiple expansion (Figure 3).

As shown in Figure 4, the median P/E for publicly-traded banks expanded about 30% to 20.6x trailing 12-month earnings at year-end from 15.9x at year-end 2015. Likewise, the median P/TBV multiple expanded to 181% from 140%. While bank stocks closed the year at the highest P/E level seen this century, P/TBV multiples remain below the pre-crisis peak given lower ROEs (ROTCEs), which in turn are attributable to higher capital and lower NIMs.

Figure 5 on page 3 summarizes profitability by asset size. Banks with assets between $5 and $10 billion were the most profitable on an ROA basis and realized the highest total returns for the year. This group stands to benefit the most from regulatory reform if the Dodd-Frank $10 billion threshold (and $50 billion for SIFIs) is raised. In the most optimistic scenario, the market appears to be discounting that banks' profitability will materially improve with lower tax rates, higher rates, and less regulation. The corollary to this is that the stocks are not as expensive as they appear because forward earnings will be higher provided credit costs remain modest. Based upon our review, most analysts have incorporated lower tax rates into their 2018 estimates, which accounts for much more modest P/Es based upon 2018 consensus estimates compared to 2017 consensus estimates.

Figure 4: Price/Earnings and Price/Book Value Multiples



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
P/E	11.9	14.3	14.3	17.0	18.5	16.2	16.6	13.9	14.3	16.5	16.4	13.6	13.4	16.2	16.1	15.9	20.6
P/TBV	146	166	181	238	247	226	225	169	122	100	114	98	113	140	138	140	181

Source: S&P Global Market Intelligence

Figure 5: Profitability by Asset Size

Asset Size	# of Banks	Avg. Price/ Tang Book	Avg. Price/ LTM EPS	Avg. Total Return	Avg. ROAA	Avg. ROATCE	Avg. NPAs/ Loans + ORE
Less than $500 Million	30	121x	26.1x	19.6%	0.70%	4.8%	3.17%
$500 Million - $1 Billion	67	136x	20.7x	33.3%	0.74%	7.5%	3.38%
$1 to $5 Billion	176	187x	22.1x	41.6%	0.88%	9.7%	2.23%
$5 - $10 Billion	57	253x	23.1x	44.3%	1.03%	12.5%	1.47%
$10 to $50 Billion	53	228x	22.4x	37.1%	1.00%	12.0%	1.59%
$50 Billion +	23	204x	18.6x	32.8%	0.96%	12.5%	1.68%
Total Group	**406**	**189x**	**22.1x**	**38.1%**	**0.89%**	**9.67%**	**2.26%**

Source: S&P Global Market Intelligence

What We're Reading

For those who didn't have the pleasure of attending Bank Director's Acquire or Be Acquired *conference in Phoenix with us this year, several of our colleagues put together nice recaps of their parting thoughts from the conference, which we have included below.*

The first article comes from Chris Nichols at CenterState and is entitled "**The 10 Best Things We Learned At the Acquire or Be Acquired Conference**."

The second recap comes in podcast form from attorneys Jim McAlpin, Jonathan Hightower, and Rob Klingler of Bryan Cave and is entitled "**AOBA Takeaways**."

The third article comes from Steve Williams and Scott Sommer at Cornerstone Advisors and is entitled "**Acquire or Be Acquired: Can Banks Get Better While Getting Bigger?**"

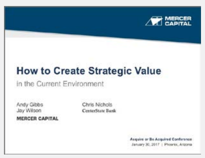
2016 M&A Trends

On the surface, 2016 M&A activity eased modestly from 2014 and 2015 levels based upon fewer transactions announced; however, when measured relative to the number of banks and thrifts at the beginning of the year, 2016 was consistent with the long-running trend of 2-4% of institutions being acquired each year. The 246 announced transactions represented 3.8% of the 6,122 chartered institutions at the beginning of the year compared to 4.5% for 2014 and 4.2% for 2015 (Figure 6 on page 4).

As for pricing, median multiples softened a little bit, but we do not read much into that. Last year, the median P/TBV multiple for transactions in which deal pricing was disclosed eased to 136% compared to 142% in 2015; the median P/E based upon trailing 12 month earnings as reported declined to 21.2x versus 24.4x in 2015 (Figure 7 on page 4).

Mercer Capital Presentation

How to Create Strategic Value in the Current Environment

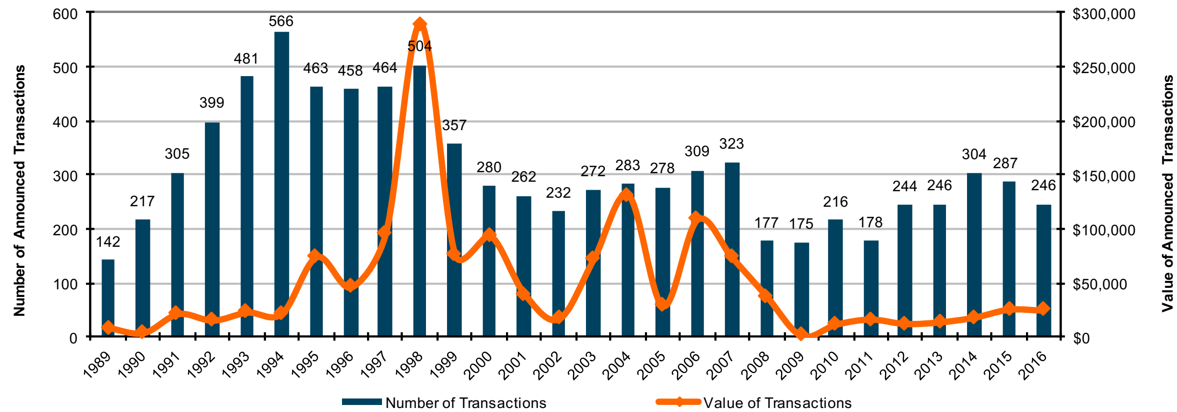


Download Slides

Against a backdrop of compressed net interest margins, enhanced competition from non-banks, rising regulatory and compliance costs and evolving consumer preferences regarding the delivery of financial services, many community banks find themselves at a significant inflection point where traditional growth strategies like building or acquiring an expansive, and often expensive, branch network are being reexamined. In this session, we examine how banks can utilize a hybrid approach and co-opt, partner with, or acquire fintech companies, wealth management and trust operations, and insurance brokerages.

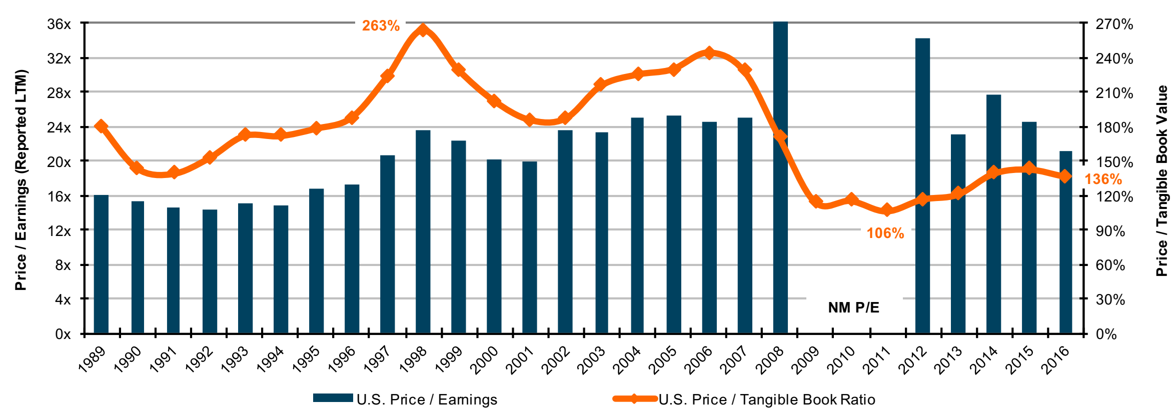
Presented by Mercer Capital's Andrew Gibbs and Jay Wilson and CenterState Bank's Chris Nichols at Bank Director's 2017 Acquire or Be Acquired Conference.

Figure 6: Long-Term M&A Trends



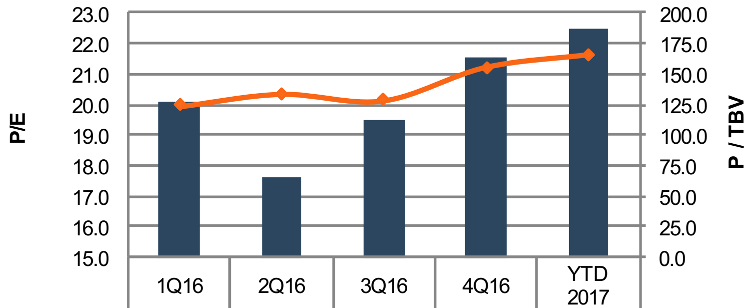
Source: S&P Global Market Intelligence

Figure 7: Median M&A Multiples



Source: S&P Global Market Intelligence

Figure 8: Trend in Acquisition Multiples Based on Announced Deal Value



	1Q16	2Q16	3Q16	4Q16	YTD 2017
Median P/E	20.1	17.7	19.5	21.5	22.5
Median P/TBV	123.4	133.4	128.1	154.7	164.7

Source: S&P Global Market Intelligence

Figure 9: Change in Deal Multiples

	Based on Announced Deal Value	Based on Final Deal Value	% Change in Multiple
	Median P/E		
Deals Announced & Closed Pre-Election	18.7	19.5	4.3%
Deals Announced Pre-Election & Closed Post-Election	19.0	21.3	12.1%
	Median P/TBV		
Deals Announced & Closed Pre-Election	124.6	123.3	-1.1%
Deals Announced Pre-Election & Closed Post-Election	123.6	134.9	9.1%

Source: S&P Global Market Intelligence

Elevated public market multiples since the national election have set the stage for higher M&A multiples in 2017 as publicly-traded buyers can "pay" a higher price with elevated share prices (Figure 8). The impact of this was seen among some larger transactions announced after the national election compared to when LOIs were announced earlier in the Fall. Activity may not necessarily pick-up with higher nominal prices, however, if would be sellers decide to wait for higher earnings as a result of anticipated increases in rates and lower taxes and regulations. In effect, some may wait for even better values or decide not to sell because ROEs improve sufficiently to justify remaining independent. Time will tell.

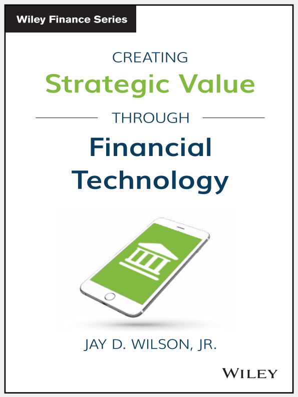
Figure 9 shows the change in deal multiples from announcement to closing and compares the change between deals announced and closed pre-election to those closed post-election. With the run-up in pricing, P/E and P/TBV multiples increased 12% and 9% from announcement to close compared to 4% and a decline of 1% pre-election.

2017 Outlook

No one knows what the future holds, although one can assess probabilities. An old market saw states "buy the rumor; sell the news" which means stocks move before the expected news comes to pass. As of the date of the drafting of this note (February 7), bank stocks are roughly flat in 2017. The stocks have priced in the likelihood of some roll-back in Dodd-Frank, higher short-term and long-term rates, lower tax rates, and a generally more favorable economic backdrop that supports loan growth and asset quality. The magnitude of these likely – but not preordained – outcomes and the timing are unknown. Following a big rally in 2016, returns for bank stocks may be muted in 2017 even if events in Washington and the Fed prove to be favorable for banks.

NEW BOOK COMING IN SPRING 2017

Creating Strategic Value Through Financial Technology



Learn More

While many bankers view FinTech as a potential threat, FinTech offers the potential to improve the health of community banks for those banks that can selectively leverage FinTech to enhance performance, customer satisfaction, and improve profitability and returns. FinTech can also help level the playing field for community banks to compete more effectively with larger banks and non-bank lenders.

Creating Strategic Value Through Financial Technology illustrates the potential benefits of FinTech to banks, both large and small, so that they can gain a better understanding of FinTech and how it can create value for their shareholders and enhance the health and profitability of their institutions.

The book contains 13 chapters broken into three sections. Section I introduces FinTech. Section II explores FinTech niches such as bank technology, alternative lending, payments, wealth management, and insurance niches. Section III illustrates how both community banks and FinTech companies can create strategic value.

That said, higher stock prices and investor demand for reasonable yielding sub-debt from quality issuers implies the M&A market for banks should be solid. The one caveat is that there are fewer banks, so a healthy M&A market for banks could still entail fewer transactions than were recorded in 2016.

Mercer Capital is a national business valuation and financial advisory firm. Financial Institutions are the cornerstone of our practice. To discuss a valuation or transaction issue in confidence, feel free to contact us.

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MERCER CAPITAL

Recent Transactions

Simmons First National Corp.
Pine Bluff, Arkansas

has agreed to acquire

First Texas BHC, Inc.
Fort Worth, Texas

Mercer Capital served as a financial advisor & rendered a fairness opinion on behalf of Simmons First National Corp.

– January 2017 –

advia credit union
Parchment, Michigan

has agreed to acquired

Peoples Bank
Elkhorn, Wisconsin

Mercer Capital served as financial advisor to Advia Credit Union

– January 2017 –

Simmons First National Corp.
Pine Bluff, Arkansas

has agreed to acquire

Southwest Bancorp, Inc.
Stillwater, Oklahoma

Mercer Capital rendered a fairness opinion on behalf of Simmons First National Corp.

– December 2016 –

Simmons First National Corp.
Pine Bluff, Arkansas

has agreed to acquire

Hardeman County Investment Company, Inc.
Jackson, Tennessee

Mercer Capital served as a financial advisor & rendered a fairness opinion on behalf of Simmons First National Corp.

– November 2016 –

Mercer Capital has experience assisting depository institutions with significant corporate transactions. Whether considering an acquisition, a sale, or simply planning for future growth, Mercer Capital has the experience required to help financial institutions accomplish their financial objectives.

Advisory Services

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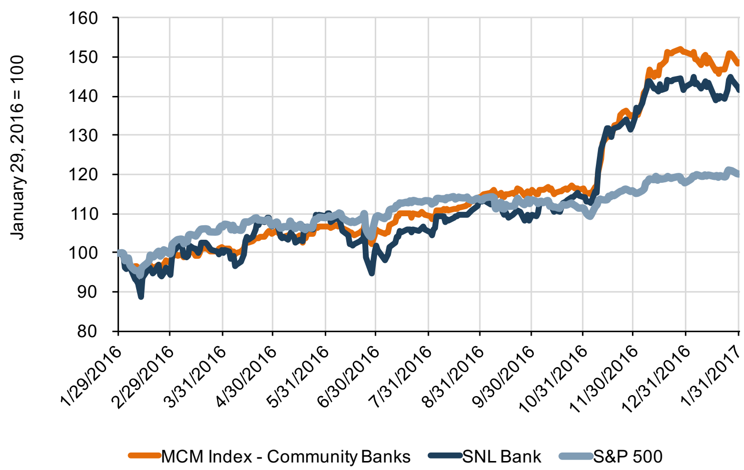
» Buy-side and sell-side financial advisory services
» Fairness opinions
» Advisory and consultation regarding capital transactions (raising, deploying, and restructuring capital)

Representative Depository Institution Services

» Capital planning and consulting
» Branch transactions
» Regulatory-assisted transactions
» Bank stress testing

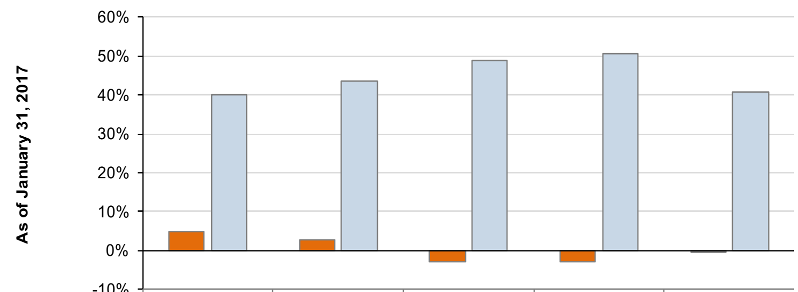
Learn More about our Transaction Advisory Services

Mercer Capital's Bank Group Index Overview



Return Stratification of U.S. Banks

by Asset Size



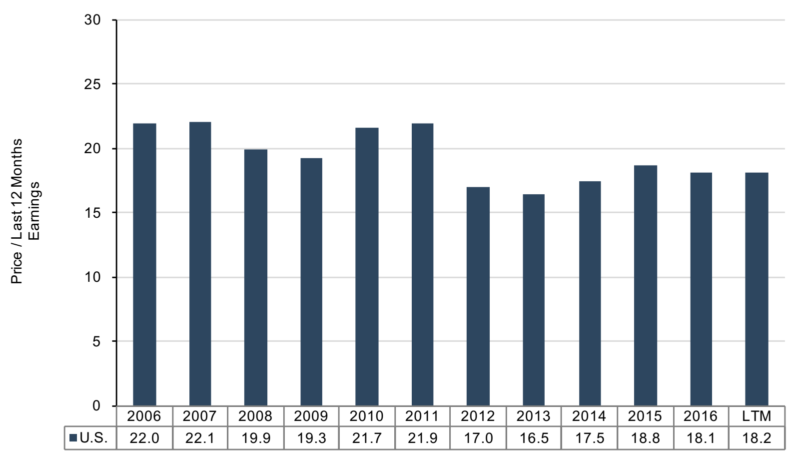
	Assets $250 - $500M	Assets $500M - $1B	Assets $1 - $5B	Assets $5 - $10B	Assets > $10B
Month-to-Date	4.82%	2.80%	-2.76%	-3.03%	-0.22%
Last 12 Months	39.88%	43.72%	48.88%	50.75%	40.80%

Median Valuation Multiples

	Median Total Return as of January 31, 2017		Median Valuation Multiples as of January 31, 2017					
Indices	Month-to-Date	Last 12 Months	Price/ LTM EPS	Price / 17(E) EPS	Price / 18(E) EPS	Price / Book Value	Price / Tangible Book Value	Dividend Yield
Atlantic Coast Index	0.87%	47.34%	20.3x	18.5x	15.4x	142%	146%	1.5%
Midwest Index	-4.08%	50.87%	18.0x	16.2x	14.6x	150%	180%	1.9%
Northeast Index	-5.14%	42.74%	16.7x	16.4x	14.0x	150%	164%	2.2%
Southeast Index	-1.87%	47.56%	17.3x	17.8x	15.1x	145%	149%	1.3%
West Index	3.11%	55.80%	19.4x	18.5x	16.5x	164%	176%	1.6%
Community Bank Index	-1.67%	48.66%	18.4x	17.4x	14.9x	149%	165%	1.7%
SNL Bank Index	**-0.42%**	**41.52%**						

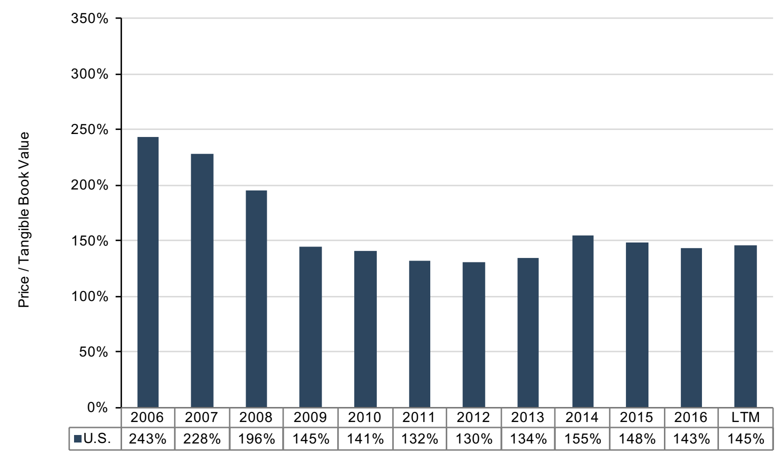
Median Price/Earnings Multiples

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



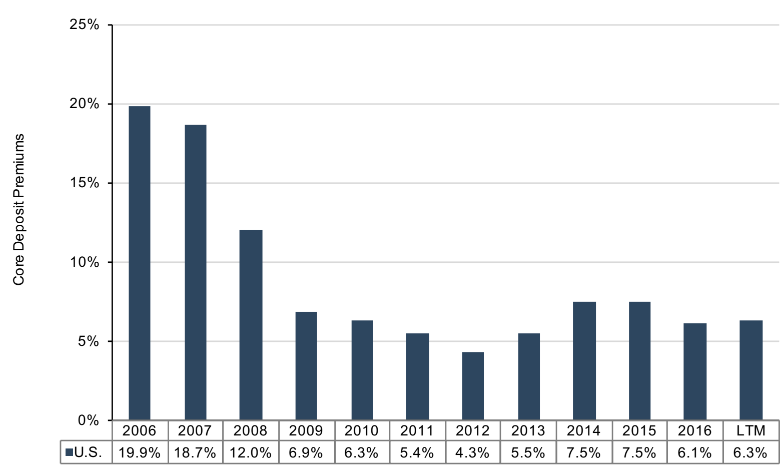
Median Price/Tangible Book Value Multiples

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

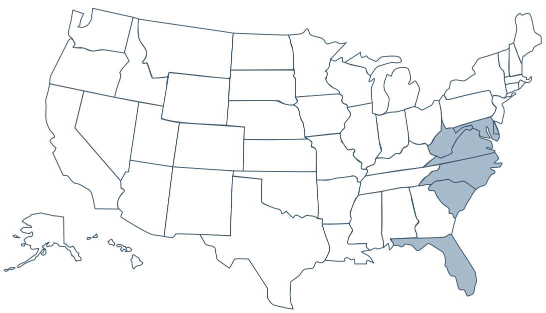
Target Banks' Assets <$5B and LTM ROE >5%, 12 months ended January 2017

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	20.4x	155%	6.9%	18	42.99	395,420	7.32%
Midwest	17.4x	141%	5.6%	70	25.57	116,117	8.11%
Northeast	20.7x	185%	8.9%	6	90.56	623,179	8.28%
Southeast	17.4x	146%	6.0%	23	58.43	186,063	7.92%
West	18.0x	157%	7.5%	15	52.87	231,574	10.55%
National Community Banks	**18.2x**	**145%**	**6.3%**	**132**	**37.65**	**190,732**	**8.19%**

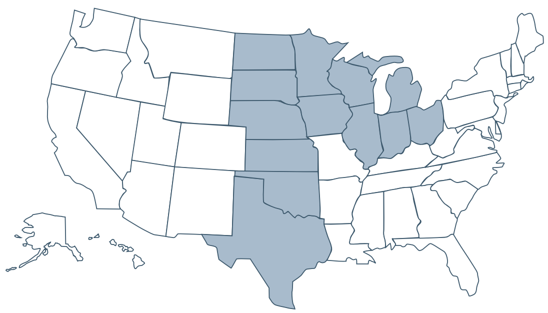
Source: S&P Global Market Intelligence

Mercer Capital's Regional Public Bank Peer Reports

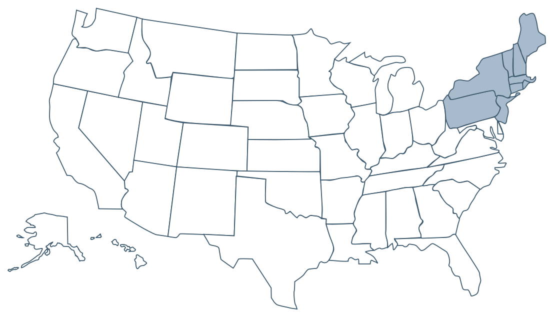
Updated weekly, Mercer Capital's Regional Public Bank Peer Reports offer a closer look at the market pricing and performance of publicly traded banks in the states of five U.S. regions. Click on the map to view the reports from the representative region.



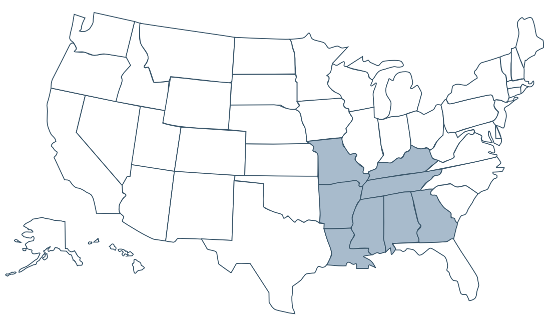
Atlantic Coast



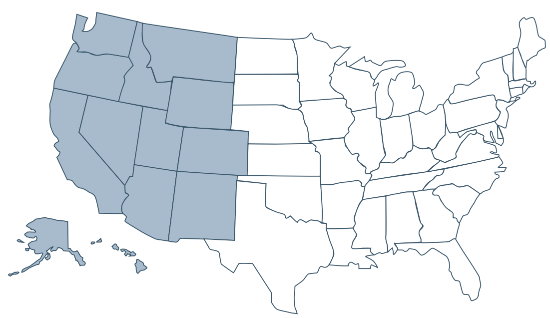
Midwest



Northeast



Southeast



West

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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
- Stress Testing
- 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**.

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