



BUSINESS VALUATION &
FINANCIAL ADVISORY SERVICES

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OCTOBER 2021

Bank Watch

ARTICLE

Value Drivers in Flux

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Value Drivers in Flux

Last July I gave a presentation to the third-year students attending the *Consumer Bankers Association's* Executive Banking School. The presentation, which can be found [here](#), touched on three big valuation themes for bank investors: estimate revisions, earning power and long-term growth.

Although Wall Street is overly focused on the quarterly earnings process, investors care because of what quarterly results imply about earnings (or cash flow) estimates for the next year and more generally about a company's earning power. Earning beats that are based upon fundamentals of faster revenue growth and/or positive operating leverage usually will result in rising estimates and an increase in the share price. The opposite is true, too.

For U.S. banks that have largely finished reporting third quarter results, questions about all three—especially earning power—are in flux more than usual. Industry profitability has always been cyclical, but what is normal depends. Since the early 1980s, there have been fewer recessions that have resulted in long periods of low credit costs. Monetary policy has been radical since 2008. What's normal was also distorted in 2020 and 2021 by PPP income that padded earnings but will evaporate in 2023.

Most banks beat consensus EPS estimates, largely due to negligible credit costs if not negative loan loss provisions as COVID-19 related reserve builds that occurred in 2020 proved to be too much; however, there was no new news with the earnings release as it relates to credit.

Investors concluded with the release of third and fourth quarter 2020 results that credit losses would not be outsized. Overlaid was confirmation from the corporate bond market as spreads on high yield bonds, CLOs and other structured products began to narrow in the second quarter of 2020 as banks were still building reserves.


As of October 28, 2021, the NASDAQ Bank Index has risen 78% over the past year and 39% year-to-date.

Much of that gain occurred during November (October 2020 was a strong month, too) through May as investors initially priced-in reserve releases to come; and then NIMs that might not fall as far as feared as the yield on the 10-year UST doubled to 1.75% by late March. Bank stocks underperformed the market during the summer as the 10-year UST yield fell. Since late September banks rallied again as investors began to price rate hikes by the Fed beginning in 2022 rather than 2023.

No one knows for sure; the future is always uncertain. For banks, two key variables have an outsized influence on earnings other than credit costs: loan demand and rates. In other industries the variables are called volume and price. If both rise, most banks will see a pronounced increase in earnings as revenues rise and presumably operating leverage improves. Street estimates for 2022 and 2023 will rise, and investors' view of earning power will too.

We do not know what the future will be either. Loan demand and excess liquidity have been counter cyclical forces in the banking industry since banks came into being. The question is not if but how strong loan demand will be when the cycle turns. Interest rates used to be cyclical, too, until governments became so indebted that “normal” rates apparently cannot be tolerated.

Nonetheless, at Mercer Capital we have decades of experience of evaluating earnings, earning power, multiples and other value drivers. Please give us a call if we can assist your institution.



Jeff K. Davis, CFA

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Recent Representative Transaction

Mercer Capital served as financial advisor to the board of directors to establish a range of value at which certain shareholders would receive cash and rendered a fairness opinion in a go-private transaction



KYZEN Corporation
Nashville, TN

Cash-Out Merger

Mercer Capital served as financial advisor to the board of directors to establish a range of value at which certain shareholders would receive cash and rendered a fairness opinion in a go-private transaction

– August 2021 –

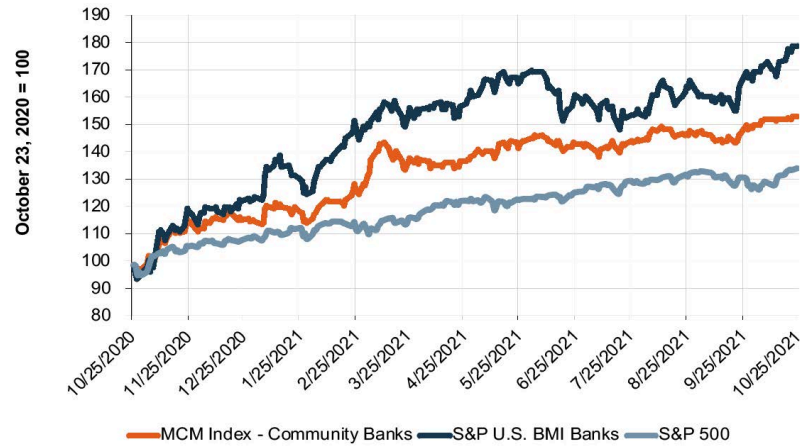
WHAT WE'RE READING

Fueled by rising vaccination rates and federal spending, the U.S. economy has recovered at a rapid pace from the COVID-19 pandemic. As the Fed prepares to begin **reducing its bond purchases**, markets are reflecting increased expectations for rate increases by the end of next year.

Recently released economic data shows that supply bottlenecks and the Delta variant of COVID-19 dented growth in the third quarter. While supply constraints may linger well into 2022, **economists** expect growth to be lifted by consumer demand and the lessening of pandemic impacts in coming months.

While neobanks and fintechs have product advantages over traditional banks, incumbents are well positioned in terms of trustworthiness and personal relationships. *Banking Exchange's* **review** of the **EY 2021 NextWave Global Consumer Banking Survey** offers insights into the challenges and opportunities offered by neobanks.

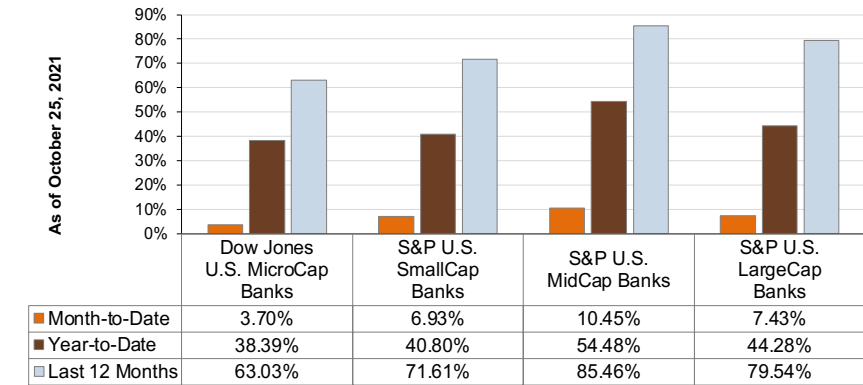
Mercer Capital's Bank Group Index Overview



Source: S&P Capital IQ Pro.

Return Stratification of U.S. Banks

by Market Cap



Micro Cap: < \$250 Million
Small Cap: \$250 Million - \$1 Billion

Mid Cap: \$1 - \$5 Billion
Large Cap: > \$5 Billion

Source: S&P Capital IQ Pro.

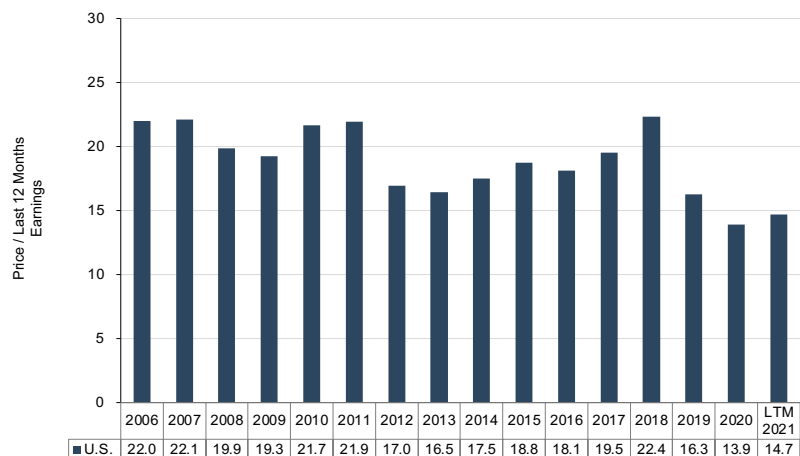
Regional Index Data

	Total Return			Regional Index Data as of October 25, 2021					
	Month-to-Date	Year-to-Date	Last 12 Months	Price/LTM EPS	Price / 2021 (E) EPS	Price / 2022 (E) EPS	Price / Book Value	Tangible Book Value	Dividend Yield
Atlantic Coast Index	2.3%	47.2%	76.7%	11.6x	11.6x	12.7x	117%	125%	2.4%
Midwest Index	2.4%	22.7%	36.9%	10.1x	9.7x	11.5x	110%	119%	2.4%
Northeast Index	3.0%	33.2%	52.8%	9.8x	9.5x	10.5x	108%	116%	2.8%
Southeast Index	3.0%	32.0%	49.4%	10.8x	10.4x	11.2x	113%	119%	2.2%
West Index	3.1%	37.9%	56.9%	10.3x	10.0x	11.4x	118%	128%	2.3%
Community Bank Index	2.7%	33.5%	52.8%	10.1x	10.4x	11.3x	111%	120%	2.5%
S&P U.S. BMI Banks	7.6%	44.4%	78.3%	na	na	na	na	na	na

Source: S&P Capital IQ Pro.

Median Price/Earnings Multiples

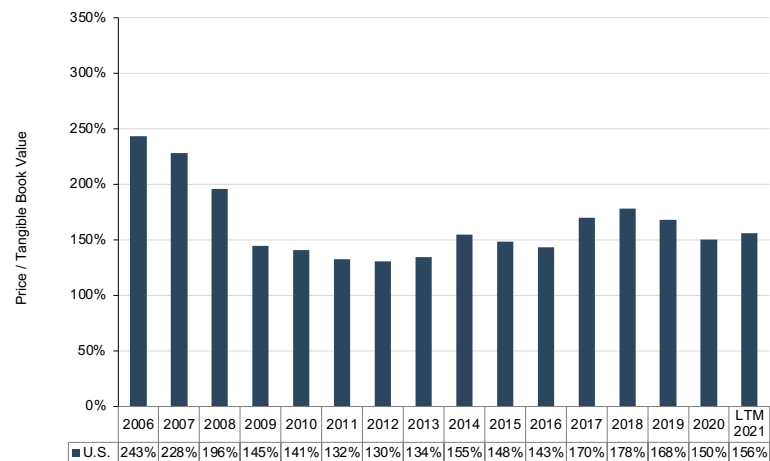
Target Banks' Assets <\$5B and LTM ROE >5%



Source: S&P Capital IQ Pro.

Median Price/Tangible Book Value Multiples

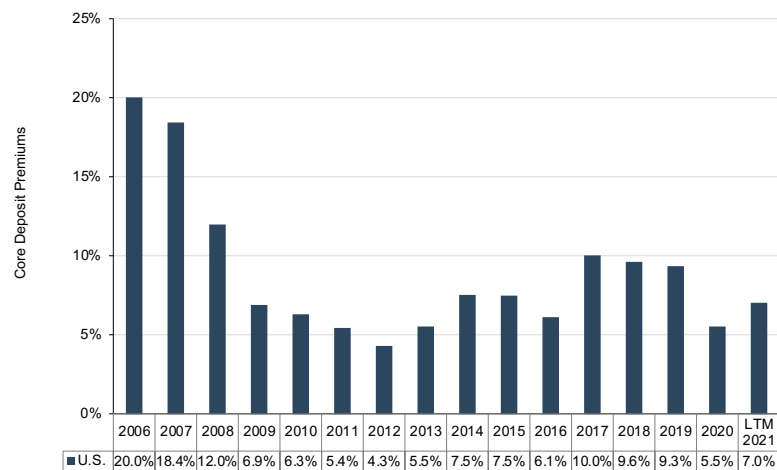
Target Banks' Assets <\$5B and LTM ROE >5%



Source: S&P Capital IQ Pro.

Median Core Deposit Multiples

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



Source: S&P Capital IQ Pro.

Median Valuation Multiples for M&A Deals

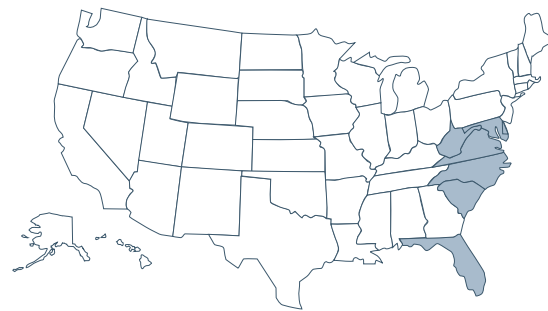
Target Banks' Assets <\$5B and LTM ROE >5%, 12 months ended October 25, 2021

Regions	Price / LTM Earnings	Price/ Tang. BV	Price / Core Dep Premium	No. of Deals	Median Deal Value (\$M)	Target's Median Assets (\$000)	Target's Median LTM ROAE
Atlantic Coast	17.2x	181%	9.4%	13	130.6	656,023	10.6%
Midwest	16.7x	155%	6.8%	47	109.2	196,820	9.2%
Northeast	14.8x	161%	7.3%	3	231.9	1,313,073	11.2%
Southeast	13.6x	153%	7.3%	27	108.4	424,031	10.8%
West	14.7x	157%	6.8%	16	134.7	757,929	11.0%
National Community Banks	14.7x	156%	7.0%	106	116.6	380,506	10.4%

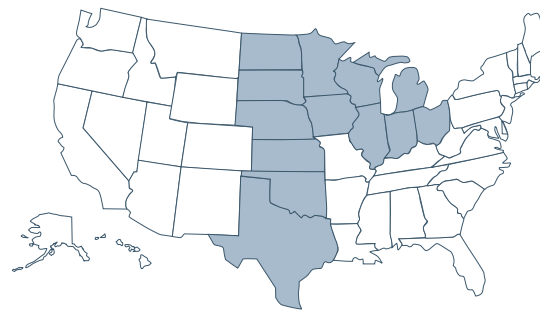
Source: S&P Capital IQ Pro.

Mercer Capital's Regional Public Bank Peer Reports

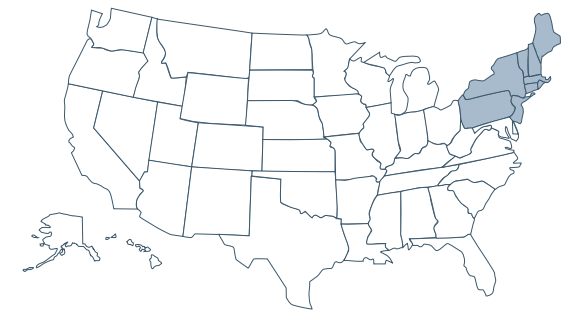
Updated weekly, Mercer Capital's Regional Public Bank Peer Reports offer a closer look at the market pricing and performance of publicly traded banks in the states of five U.S. regions. Click on the map to view the reports from the representative region.



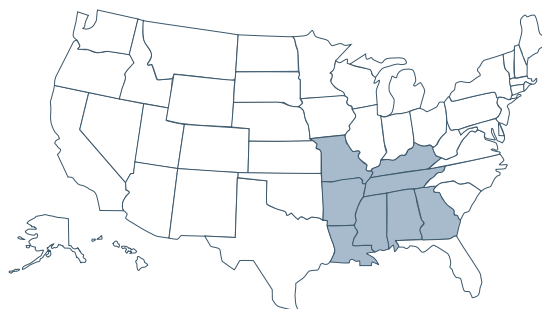
Atlantic Coast



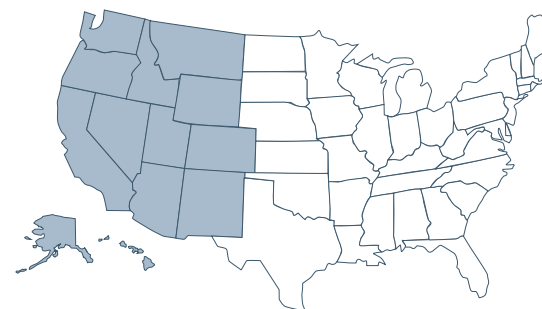
Midwest



Northeast



Southeast



West

MERCER CAPITAL

Depository Institutions Services

Mercer Capital assists banks, thrifts, and credit unions with significant corporate valuation requirements, transaction 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

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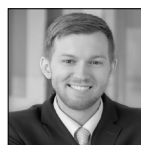
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