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NASHVILLE NOTES

Friday, June 03, 2016 8:31 AM ET

Yadkin Financial Corp. may not be a slam dunk

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Bloomberg News reported on May 25 that Raleigh, N.C.-based Yadkin Financial Corp. has hired Sandler O'Neill & Partners LP to explore a sale. Following the news, analysts and investors were generally not surprised the board could be moving to sell for several reasons. Avoiding the cost of crossing the Dodd-Frank Rubicon of $10 billion of assets was cited as one reason. I would add no one goes broke taking a profit. There seems to be disagreement what the shares might command in an acquisition.

I am offering my two bits.

Yadkin could be a compelling strategic acquisition. Almost all of its $5.2 billion of deposits are domiciled in North Carolina where it had the seventh-largest market share position as of June 30, 2015. It does not have a dominating presence in the major MSAs, but enough to be meaningful, I think, to a wide array of potential acquirers such as First Horizon National Corp. Synovus Financial Corp. and possibly PNC Financial Services Group Inc. and Fifth Third Bancorp. Given its deep roots in the state, a lower Wall Street profile (there is no analyst coverage) and perhaps a longer-term view of investing than a "typical" publicly held bank, Raleigh-based First Citizens BancShares Inc. might be the most logical acquirer. An in-market acquirer should be able to realize the most synergies and rationalize a higher acquisition price.

An alternative transaction might entail a merger-of-equals or quasi MOE. My non-legal opinion is that boards are not required to run auctions to solicit the highest price as long as there is a reasonable plan to create long-term value when contemplating a course of action. MOE partners might include South State Corp., Capital Bank Financial Corp. or United Community Banks Inc. In a year or so, BNC Bancorp might be an option, too, once it has consummated and integrated its pending acquisitions of Southcoast Financial Corp. and High Point Bank Corp.

MOEs can be compelling transactions if execution risks are manageable, earnings accretion is sizable and the merged entity is viewed by investors as having a higher growth rate and strategic value (in a sale) than the two banks on stand-alone basis. If so, investors should be able to justify a higher P/E on the higher pro forma EPS. That is an ideal scenario for an MOE; others might describe it as a unicorn. MOEs also are ideal when one or both parties do not have a potential acquirer. There are other advantages, too, such as potentially enhanced dividends and improved share liquidity.

Yadkin's institutional investors might flip out over an MOE if they were convinced a large bank that would be deemed an acquirer could pay a sizable premium. Wall Street usually is for maximum realizable value now rather than waiting patiently for value to be created when given the option. The carping among shareholders about the pending MOE between Chemical Financial Corp. and Talmer Bancorp Inc. is an example of investor angst over "price" versus long-term "value" creation potential in an MOE. If Coach Bryant were a bank investor rather than a football coach, he might describe an MOE like "kissing your sister," which is how he described ties before college football adopted the playoff format years after his death.

Although Yadkin seemingly will have a number of attractive options, I see two potential related issues that may pre-empt a slam dunk in terms of a price that excites the Street.

The obvious one is valuation. As of June 1, Yadkin's shares traded for 19.6x consensus 2016 earnings, 13.7x 2017 consensus earnings and 222% of tangible book value. The shares are expensive. I realize the jump in projected earnings between 2016 and 2017 reflects the anticipated synergies to be realized from the March 1 acquisition of NewBridge Bancorp. Nevertheless, I think the shares are rich and thereby will impact the potential premium absent a bank such as First Citizens being able to realize large expense synergies.

The second issue follows from the first: earning power. Yadkin represents a recent roll-up of a number of banks. Many (or most) publicly traded banks are roll-ups when viewed over 10 or 20 years, but Yadkin has added a lot of assets the past few years. The March acquisition of NewBridge added $2.8 billion of assets, which equates to about 37% of Yadkin's $7.4 billion of assets as of March 31. NewBridge added nearly $550 million of assets through two acquisitions that closed in April 2014 and February 2015. During July 2014 Yadkin added $2 billion of assets via an MOE with VantageSouth Bancshares Inc., which in turn had acquired about $900 million of assets through the April 2013 acquisition of ECB Bancorp Inc.

In short, there is no earnings history for Yadkin as currently constituted for even a one-year period after synergies have been realized from recent transactions much less through a full business and credit cycle. The earning power issue is further clouded by purchase accounting from past acquisitions. Yadkin's first quarter GAAP NIM was 4.05% compared to the core NIM that excludes all purchase accounting impacts of 3.70%.

The earning power question, I think, will matter one way or the other to an acquirer or merger partner. While the issue(s) can be modeled, the degree of confidence will not be the same as observing a historical track record. After all, it is a lot easier to get paid for what a bank has made compared to what it plans to make, much less what analysts say it will make in 2017.

Assuming the Bloomberg report is correct, the timing to move to sell the company now raises another issue. Why now rather than waiting until 2017 to start the process? I am sure there is a good reason, but I do not know what it may be other than the M&A environment for well-situated sellers is good today even though Yadkin's timing is not 100% optimal. Markets and the economy may not be as favorable next year.

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