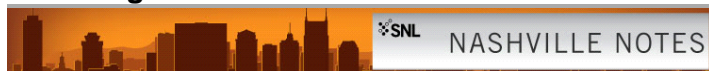


## SNL Blogs



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## Comerica and agitating for a sale

By [Jeff K. Davis](#)

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One of the basic tenets of deal making is this: when a board needs an acquirer to step forward to pay an irrational price — or perhaps just make an offer — such a buyer is usually confined to a banker's PowerPoint presentation. Dick Fuld as CEO of Lehman Brothers when it failed in 2008 knows the capital raising equivalent: when a company absolutely has to raise funds to roll maturing debt to survive, it is tough to raise it at any price. The corollary to both of these is the opposite: when a company does not have to have a buyer or raise capital, the pricing can be attractive and sometimes irrationally so.

Comerica Inc.'s management and board are in what probably is an uncomfortable spot. Earlier this year [Hudson Executive Capital LP](#) disclosed its soft-velvet approach to [push](#) the company to sell. Its executive advisers include bankers Bill Harrison ([JPMorgan Chase & Co.](#)), Richard Kovacevich ([Wells Fargo & Co.](#)) and Howard Milstein ([New York Private Bank & Trust Corp.](#)). Comerica was featured a couple of times in April in *The Wall Street Journal*, including an April 22 story about CLSA bank analyst Mike Mayo's effort or perhaps voice on behalf of some institutional shareholders to explore a sale. It is not the kind of publicity any management would want.

For Wall Street the math that matters is share performance. Does a stock deliver alpha or biological bricks to a portfolio? During the five-year period ended April 30 the total return was 28%, which was about half the median return for U.S. banks with assets greater than \$10 billion. Only in the year-to-date period have the bank's shares outperformed the broader index, but that is largely attributable to the acquisition speculation.

Among long-time followers of the company I do not think there was much surprise when a Bloomberg story reported that Comerica determined it's a bad time to pursue a sale. As a small SIFI with \$69 billion in assets, there are only a few logical buyers, and they are hamstrung. Richard Davis of [U.S. Bancorp](#) noted the company is [precluded](#) from acquiring whole banks until its regulatory consent agreement is resolved. [BB&T Corp.](#) CEO Kelly King [swore off](#) deals for the time being during the company's first-quarter conference call. Given its size it is not clear (to me) that Wells Fargo could get a merger application through the Fed, and Comerica is not a have-to-have proposition for Wells unless the price is a steal. [MUFG Union Bank NA](#) parent [Mitsubishi UFJ Financial Group Inc.](#) apparently has regulatory hurdles to clear with the Fed before acting on its stated intention to buy U.S. regional banks.

In short, it's a bad time to sell.

The underperformance of the shares and pressure from some investors and analysts can be traced to the company's returns. Comerica's ROCE and ROTCE for the last 12 months are just mediocre at 5.8% and 6.4%, respectively. During the non-boom years of 2012 to 2014 when credit costs were low its ROCE was between 7% and 8%, and ROTCE was between 8% and 9%. My back-of-the-envelope cost of capital calculation with the 10-year around 2% is 9% to 10%. Obviously GAAP ROCE and the cost of capital are not exactly the same thing given differences in charge-offs and provision expense, but there seems to be broad agreement that Comerica and many (or most) banks are not earning their cost of capital even though credit costs are low.

Comerica's predicament is both cyclical and, I think, secular. The impact of elevated energy costs is cyclical; the issue will eventually run its course — maybe this year if energy prices continue to trend higher. The secular issue is zero interest-rate policy, which the Fed and other central banks may find impossible to end. ZIRP has crushed Comerica's net interest margin as a predominantly LIBOR-based commercial lender with large amounts of noninterest deposit funding. The LTM NIM was 2.65%, while the first-quarter NIM was higher at 2.81%, but still lousy. ROE cannot be great absent support from non-spread-based business units or upping leverage.

Enter Boston Consulting Group. Comerica CEO Ralph Babb informed investors April 19 with the release of first-quarter results that BCG has been [hired](#) to analyze the bank's cost structure and revenue drivers. I am sure BCG will have many options to present to management. The theme presumably will be shrinkage, which is ironic given the pressure on the largest banks to get smaller.

One of BCG's recommendations could be a radical downsizing of the branch network rather than a more modest effort that probably would be more in-line with management's DNA. Branch networks are costly, ZIRP has devalued core deposits, and the future is mobile banking. What would be a radical downsizing? Perhaps 25% or more of the 470+ branches the company had as of June 30. Would that be enough? Would regulators approve a massive consolidation effort that left branch coverage thin in some markets? I do not know.

Aside from cutting expenses and maybe changing processes to add a few revenue dollars, I assume BCG will review the balance sheet to ask whether the asset base can be shrunk sufficiently to shed the costs that go with being larger than \$50 billion in assets. That seems unlikely, but the board should ask the question of someone other than management.

BCG has an interesting assignment, though not an easy one if the objective is to get ROE above 10%. Few have cut their way to prosperity. Perhaps Star Banc of Cincinnati and its [transformation](#) in the 1990s is an example. Aside from the issue of branch networks being rapidly displaced by technology, Comerica and the industry have a revenue issue due to ZIRP. The response may require something that is radical such as a massive branch consolidation effort. The benefits of the savings expressed in present value dollars will have to exceed the initial charge to implement the strategy by a meaningful amount. Even if the math is compelling in a PowerPoint slide, Wall Street may not like pain today for tomorrow's return.

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