

Bank Watch

Share Repurchases

This article has been adapted from the post “Bill Gross, Carl Ichan and Share Repurchases,” which originally appeared November 7, 2013 in the “Nashville Notes” blog on SNL.com. Republished with permission.

Many bank analysts have been arguing that investors should buy bank stocks because capital is building faster than it can be deployed. The Federal Reserve, unlike during the pre-crisis era, is governing the amount of capital returned to shareholders. Basel III is another governor, especially given the enhanced leverage ratio requirement large U.S. banks are facing.

But are buybacks a good idea for bank managers today? I question the wisdom of many of the repurchases that are occurring when bank stocks are trading at price-to-earnings ratios in the mid-teens and at 1.5x to 2.0x price to tangible book value. The bane of buybacks, and M&A for that matter, is the human propensity to engage in risky behavior at the top of the market when all is well and risks seem minimal.

Share buybacks are not high finance. They use excess capital or cheap debt to fund the repurchase of shares. From a flow-of-funds perspective, repurchases also support share price — especially for small-cap banks that are thinly traded. Nevertheless, I do not think it is simply a constant P/E ratio and higher EPS from a reduced share count that yields a higher stock price. Value matters as well for repurchases.

Ideally buybacks will occur when a stock is depressed, not when it is pressing a 52-week or multiyear high because the Fed has had the monetary spigots wide open for five years. The majority of publicly traded banks today are producing a return on tangible common equity in the range of 9% to 15%. If the shares are trading at 1.5x to 2.0x tangible book value, the effective return for new money is about 6% to 8% (based on the return on tangible equity divided by the price-to-tangible book value multiple) if the bank can reinvest retained earnings at a comparable return on tangible equity. Of course, returns could increase, but that seems doubtful to me when the mortgage refinancing boom is over, loan yields are grinding lower, and credit costs for many banks are low.

Price Matters: Are All A Good Use of Capital?

Mercer Capital's Bank Watch

Banks that repurchased shares in 2012 have seen varied results. It may be that banks producing the lowest returns, such as First Horizon National Corp., acquired shares in 2012 at a bargain price compared to banks that trade at higher multiples, such as Bank of Hawaii Corp.

JPMorgan Chase & Co. is an unanswered question too. Repurchases made in 2012 may prove to be money well spent provided it is not going to be needed to shore up capital for litigation-related losses. JPMorgan's 2012 repurchases occurred at an average price of \$42.19 per share, which was a modest premium to tangible book value. Today, the shares trade around \$52, even though the company's outlook may be cloudier than it was in 2008.

CapitalSource Inc., Huntington Bancshares Inc., Fifth Third Bancorp and KeyCorp appear to have spent excess capital well in 2012 given a combination of low valuations and adjusted returns in the low teens. The home run among the group is CapitalSource, which repurchased 17.2% of its year-end 2011 shares during 2012 for an average price of \$6.91 per share and has bought back 7.0% of its year-end 2012 shares during 2013 for an average price of \$9.14 per share. The company subsequently agreed to be acquired by PacWest Bancorp on July 22. Its share price was \$13.11 at the closing bell Nov. 4.

Having capital and the willpower not to repurchase requires discipline. It is also a tacit admission by the management team that the company's shares may be over-valued. So what is the alternative in the context of capital, profitability, and growth "in that order," as ex-Whitney Holding Corp. CEO Bill Marks used to say?

One option is to sit on capital waiting for the inevitable cyclical downturn, though that may be a long wait given the lack of

| Company | Ticker | 11/4/13 Closing Price (\$) | 11/4/13 Price / LTM EPS (x) | 11/4/13 Price / TBV (%) | YTD Avg. Buyback Price / YE12 TBV (%) | 2012 Avg. Buyback Price / YE 11 TBV (%) | YTD Buybacks as % of YE12 Shares (%) | 2012 Buybacks as % of YE11 Shares (%) | 2012 Adjusted ROATCE (%) |
|--------------------|--------|----------------------------|-----------------------------|-------------------------|---------------------------------------|---|--------------------------------------|---------------------------------------|--------------------------|
| Associated Banc | ASBC | 16.35 | 15.1 | 145 | 136 | 120 | 3.4 | 2.8 | 7.53 |
| Bank of Hawaii | BOH | 57.23 | 16.8 | 265 | 227 | 219 | 1.5 | 3.8 | 7.64 |
| Beneficial Mutual | BNCL | 9.85 | 54.7 | 157 | NA | 261 | 1.5 | 1.3 | 1.28 |
| Bk of NY Mellon | BK | 32.51 | 17.8 | 291 | 150 | 137 | NA | 4.1 | 16.92 |
| BOK Financial Corp | BOKF | 61.83 | 13.0 | 163 | 160 | 157 | 0.3 | 1.0 | 8.87 |
| CapitalSource | CSE | 13.11 | 17.5 | 182 | 132 | 126 | 7.0 | 17.2 | 26.81 |
| Captl Fed Finl | CFFN | 12.50 | 26.0 | 113 | 102 | 102 | 4.9 | 7.5 | 3.86 |
| Cmnty Bank System | CBU | 36.19 | 17.8 | 303 | 112 | 96 | NA | 0.0 | 16.43 |
| Comerica Inc | CMA | 43.30 | 14.8 | 126 | 179 | 171 | 3.1 | 5.2 | 4.79 |
| Commerce Bcshs Inc | CBSH | 45.75 | 16.0 | 206 | NA | NA | 1.9 | 3.0 | NA |
| East West Bancorp | EWBC | 33.55 | 16.4 | 240 | NA | 180 | NA | 6.2 | 8.43 |
| Fifth Third Bncp | FITB | 18.84 | 9.4 | 144 | NA | NA | NA | 4.8 | NA |
| First Cmnlwth Finl | FCF | 8.65 | 20.6 | 150 | NA | 92 | NA | 5.4 | 7.72 |
| First Fin Bancorp | FFBC | 15.49 | 14.8 | NA | NA | 117 | NA | 1.3 | 9.68 |
| First Horizon Natl | FHN | 11.01 | NM | 138 | NA | 151 | 3.4 | 5.6 | -0.78 |
| Frst Citizens BcSh | FCNCA | 210.26 | 12.9 | 110 | 130 | 107 | NA | 6.4 | 7.09 |
| Fulton Finl Corp | FULT | 12.19 | 14.9 | 157 | NA | 133 | 4.0 | 1.1 | 8.06 |
| Huntington Bcshrs | HBAN | 8.78 | 12.0 | 145 | 130 | 125 | 2.0 | 2.7 | 11.00 |
| Intl Bcshs Corp | IBOC | 22.87 | 15.5 | 139 | NA | 111 | NA | 0.1 | 7.77 |
| JPMorgan Chase | JPM | 52.04 | 11.8 | 134 | 130 | 127 | 2.4 | 0.9 | 11.91 |
| Kearny Finl Corp. | KRNY | 10.47 | NM | 193 | 177 | 166 | 0.2 | 1.3 | 0.83 |
| KeyCorp | KEY | 12.50 | 13.4 | 126 | 116 | 90 | 3.8 | 3.3 | 10.56 |
| MB Financial Inc | MBFI | 29.79 | 16.6 | 190 | 186 | 140 | 0.2 | 0.2 | 7.88 |
| Natl Bk Hldgs Corp | NBHC | 20.45 | NM | 110 | 98 | 94 | 2.1 | 0.0 | 0.31 |
| Natl Penn Bcshs | NPBC | 10.30 | 26.4 | 173 | NA | 151 | 0.0 | 4.9 | 7.31 |
| Northern Tr Corp | NTRS | 56.65 | 19.0 | 188 | 191 | 173 | 1.4 | 1.5 | 6.04 |
| NW Bancshares | NWBI | 13.79 | 20.0 | 135 | NA | 117 | NA | 4.5 | 5.55 |
| Old National Bncp | ONB | 14.67 | 15.0 | 189 | 162 | 155 | 0.8 | 0.3 | 7.97 |
| Oritani Finl Corp | ORIT | 16.41 | 17.5 | 142 | NA | 111 | NA | 21.5 | 5.37 |
| People's United | PBCT | 14.32 | 19.6 | 181 | 158 | 143 | 7.2 | 5.1 | 6.10 |
| Provident Fnl Svcs | PFS | 18.66 | 15.3 | 174 | 142 | 140 | 0.7 | 1.1 | 7.88 |
| Simmons First Natl | SFNC | 33.22 | 19.9 | 160 | 125 | 121 | 4.5 | 4.2 | 6.67 |
| State St Corp | STT | 70.92 | 16.2 | 271 | 246 | 195 | 5.1 | 6.9 | 9.53 |
| StellarOne Corp | STEL | 23.33 | 21.4 | 168 | NA | NA | NA | 0.0 | NA |
| UMB Financial Corp | UMBF | 58.98 | 19.9 | NA | 271 | 287 | 0.1 | 1.2 | NA |
| Union First Market | UBSH | 24.21 | 16.9 | 167 | 200 | 193 | 2.0 | 4.2 | 5.62 |
| US Bancorp | USB | 37.54 | 12.6 | 272 | 133 | 113 | 3.0 | 3.1 | 21.33 |
| ViewPoint Finl Grp | VPFG | 21.56 | 24.0 | NA | 150 | NA | 0.2 | 0.0 | NA |
| Westamerica Bncp | WABC | 52.24 | 20.0 | 347 | 299 | 313 | 3.2 | 4.0 | 6.83 |

Source: SNL Financial. Pricing as of November 4, 2013. Adjusted ROATCE equals ROATCE divided by the average price/tangible book multiple for each year.

loan growth and Fed actions that are indirectly supporting credit quality. A second option is to do acquisitions using excess capital and richly-valued shares.

A third option is to return capital via special dividends. However, Wall Street has never been as excited about special dividends compared to buybacks because they are one-time events with no impact on EPS or market demand.

If the Fed manages to engineer further appreciation in asset prices, including bank stocks, the sector may see more boards electing to use special dividends to return capital — provided the Fed is agreeable.

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Mercer Capital has three decades of experience of advising banks, non-depository financial institutions and corporations in matters related to share repurchases, capital planning and valuation for a variety of purposes. Whether considering an acquisition, a sale, or simply planning for future growth, Mercer Capital can help financial institution accomplish their objectives through informed decision making.

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What We're Reading

From *American Banker*, Harvard Winters has an interesting piece entitled "The Trouble with Cost of Equity as a Bank Performance Gauge"

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

Bloomberg's Businessweek has a good read on community banks and the importance of soft information when making loans in the article "Rural Banks Know Something Big Banks Don't"

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

An article discussing "Five Signs Your Bank Could be Tripped Up by Stress Testing," by Manus Clancy of Trepp, recently appeared in *Bank Director* magazine

<http://mer.cr/193w3QJ>

Also from *Bank Director*, a variety of industry veterans answer the question "What Aspect of M&A Transactions Do Bank Boards Understand the Least?"

<http://mer.cr/HDutPq>

New from Mercer Capital

FinTech Watch



Mercer Capital's latest newsletter focuses on the financial technology industry, providing information on corporate valuation, financial reporting, transaction advisory, and related topics.

Each quarter, Mercer Capital's FinTech Watch will provide an overview of the FinTech industry, including public market performance, valuation multiples for public FinTech companies, and articles of interest from around the web. In addition, each issue of this quarterly newsletter will focus on one FinTech segment, including payment processors, technology, and solutions companies, examining general economic and industry trends as well as a summary of M&A and venture capital activity for the segment.



Davis, Gibbs, Crow to Speak at the

2014 Acquire or Be Acquired Conference

Jeff K. Davis, CFA, Managing Director of Financial Institutions, **Andrew K. Gibbs, CFA, CPA/ABV**, Leader, Depository Institutions Group, and **Matthew R. Crow, ASA, CFA**, President of Mercer Capital, are speaking at the 2014 Acquire or Be Acquired Conference sponsored by *Bank Director* magazine.

While industry and economic headwinds challenge banks both large and small, CEOs, CFOs, Chairmen and members of the board continue to attend Bank Director's Acquire or Be Acquired Conference. They do so to network with peers and explore a variety of financial growth, strategy and M&A topics through interactive sessions and presentations. Widely regarded as one of the financial industry's premier M&A conferences, Bank Director's 20th annual "AOBA" explores issues such as strategic alliances, investors' interests and whether now is the right time to be a buyer (or a seller).

Mercer Capital's topic for the 2014 conference is "**Acquisitions of Non-Depositories by Banks.**" This session will review the opportunities and pitfalls in acquiring asset management, specialty finance, mortgage, insurance and other financial



Davis



Gibbs

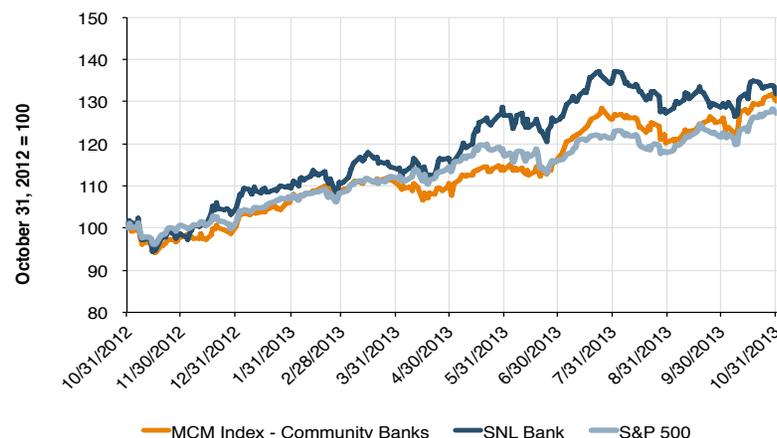


Crow

companies outside the genre of traditional bank M&A. Well-structured and reasonably-priced deals can add to an institution's franchise value through providing revenue diversification that sometimes has cross-sale opportunities and an earnings stream that may receive a higher P/E than traditional banking. If a buyer over-pays, executes poorly or underappreciates cultural differences, such acquisitions can be a disaster. The presenters will offer their views on opportunities for banks in addition to reviewing pricing trends.

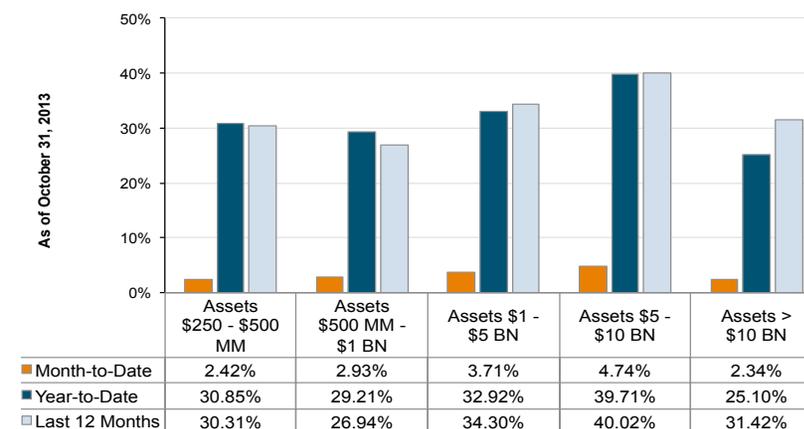
Acquire or Be Acquired is being held January 26-28, 2014 at The Phoenician Hotel in Scottsdale, Arizona.

Mercer Capital's Bank Group Index Overview



Return Stratification of U.S. Banks

by Asset Size

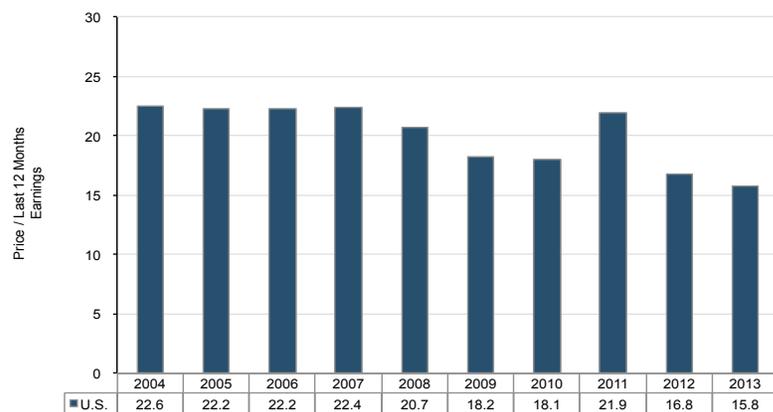


Median Valuation Multiples

| Indices | Median Total Return | | | Median Valuation Multiples as of October 31, 2013 | | | | | |
|-----------------------|---------------------|---------------|----------------|---|----------------------|----------------------|--------------------|-----------------------------|----------------|
| | Month-to-Date | Year-to-Date | Last 12 Months | Price/ LTM EPS | Price / 2013 (E) EPS | Price / 2014 (E) EPS | Price / Book Value | Price / Tangible Book Value | Dividend Yield |
| Atlantic Coast Index | 2.24% | 26.93% | 27.86% | 13.49 | 13.92 | 13.38 | 107.4% | 117.5% | 2.3% |
| Midwest Index | 3.60% | 34.80% | 35.37% | 12.77 | 12.87 | 13.24 | 109.5% | 126.5% | 2.0% |
| Northeast Index | 3.15% | 27.01% | 25.38% | 14.73 | 15.33 | 13.77 | 123.3% | 129.5% | 2.7% |
| Southeast Index | 3.80% | 29.11% | 27.44% | 13.51 | 14.20 | 13.24 | 122.7% | 141.1% | 2.2% |
| West Index | 5.89% | 30.69% | 33.81% | 14.39 | 17.67 | 15.06 | 133.1% | 136.8% | 1.8% |
| Community Bank Index | 3.73% | 29.37% | 30.02% | 13.86 | 14.32 | 13.98 | 116.0% | 128.7% | 2.2% |
| SNL Bank Index | 4.60% | 25.30% | 27.18% | na | na | na | na | na | na |

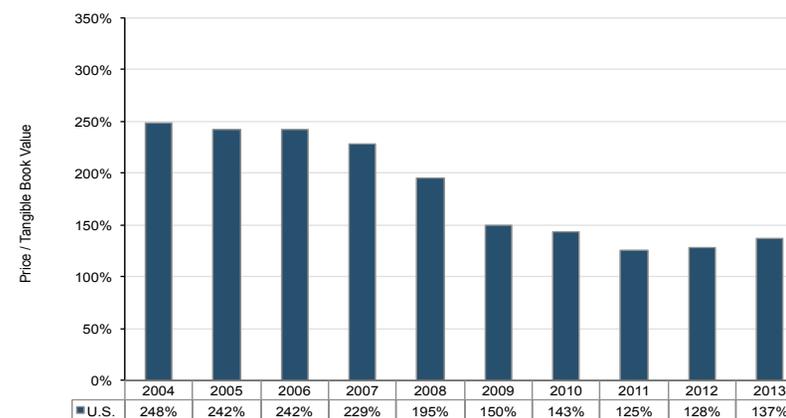
Median Price/Earnings Multiples

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



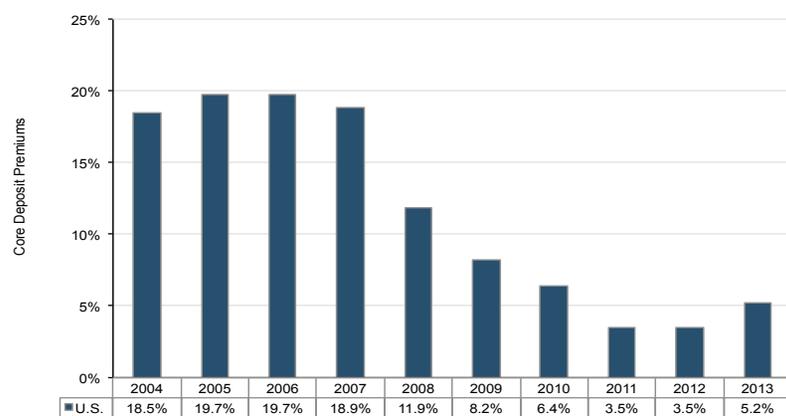
Median Price/Tangible Book Value Multiples

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



Median Core Deposit Multiples

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



Median Valuation Multiples for M&A Deals

Target Banks Assets <\$5BN and LTM ROE >5%, through October 31, 2013

| 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 ROE (%) |
|------------------------------|----------------------|------------------|--------------------------|--------------|-------------------|------------------------|-----------------------------|
| Atlantic Coast | 14.47 | 1.38 | 4.0% | 11 | 60.83 | 683,231 | 7.32% |
| Midwest | 17.12 | 1.40 | 5.9% | 47 | 29.06 | 106,785 | 9.02% |
| Northeast | 17.05 | 1.47 | 7.6% | 5 | 65.70 | 368,930 | 7.89% |
| Southeast | 13.47 | 1.28 | 3.1% | 8 | 73.34 | 173,961 | 6.81% |
| West | 15.61 | 1.33 | 5.8% | 16 | 38.82 | 242,484 | 7.15% |
| Nat'l Community Banks | 15.76 | 1.37 | 5.2% | 87 | 40.51 | 214,052 | 8.15% |

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.

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* (2011), *Acquiring a Failed Bank* (2010), *The Bank Director's Valuation Handbook* (2009), and *Valuing Financial Institutions* (1992), Mercer Capital professionals speak at industry and educational conferences.

The Financial Institutions Group of Mercer Capital publishes *Bank Watch*, a monthly e-mail newsletter covering five U.S. regions. In addition, Jeff Davis, Managing Director, is a regular contributor to SNL Financial.

For more information about Mercer Capital, visit www.mercercapital.com.

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