

Bank Watch

October 2017

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Core Deposit Intangible Asset Values and Deposit Premiums Update

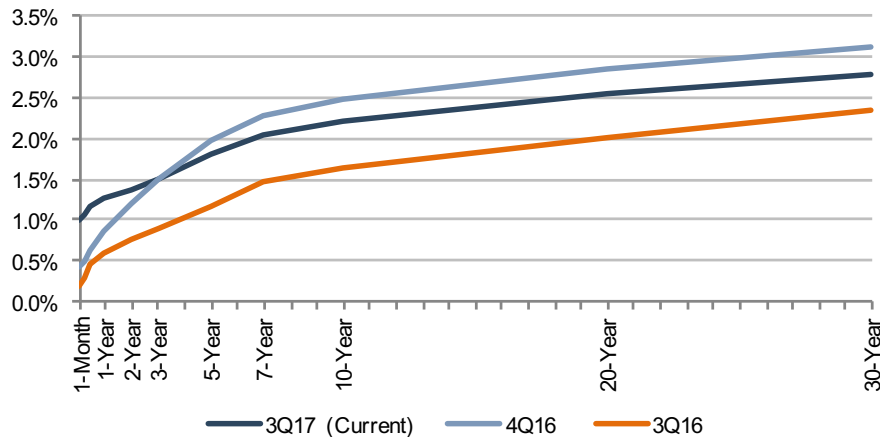
In 2016, Mercer Capital [published an article on core deposit trends through November 1](#) just before the presidential election. At that time, core deposit intangible (CDI) values remained near historical lows. Following the financial crisis, CDI values decreased as deposits have less worth, so to speak, in a very low rate environment than in a “normal” environment as existed before the crisis. Despite a rate increase by the FOMC in December 2015, the costs of

alternative funds such as FHLB advances had not materially increased and were not expected to increase more than the gradual pace the Fed had targeted for short-term interest rates since late 2015. The persistent low rate environment limited both deposit premiums paid in acquisitions and CDI values booked.

A week later, the presidential election defied market expectations and drove bond yields higher almost immediately on expectations of stronger economic growth and rising inflation. Three more rate increases by the FOMC followed in December 2016, March 2017, and June 2017. Since the post-election run-up, the yield curve has flattened, but overall yields remain well above pre-election levels (Chart 1).

Using data compiled by S&P Global Market Intelligence, we analyzed trends in CDI assets recorded in whole bank acquisitions completed from 2008 through the third quarter of 2017, and we compared CDIs recorded as a percentage of core deposits acquired to 5-year FHLB rates over the same period. CDI values generally have followed interest rate trends. Prior to the start of the financial crisis, CDIs recorded in acquisitions averaged 1.5%–2.0%, but post-crisis CDIs stabilized at approximately 1.0%–1.25% in the 2014 to 2016 period. Since the November 2016 election, CDI values have risen through mid-2017 as yields rose, before declining in the third quarter as the yield curve flattened. CDIs represent the benefit of having a low-cost, stable funding source, and in times when alternative sources of funds have higher rates, core deposits have greater “worth” to an acquirer (see Chart 2 on the next page).

Chart 1: U.S. Treasury Yield Curve



Source: Federal Reserve Statistical Release H.15

Note: Figures shown are the average yield for the last month of the quarter.

Although CDI values have increased since the post-crisis lows, CDI values remain well below long-term historical average levels. CDI values have averaged approximately 1.5% in 2017, compared to averages in the 2.5%–3.0% range in the early 2000s. Even as CDI values remained largely stagnant through 2016, deposit premiums paid in whole bank acquisitions have shown more volatility, driven by improved deal values that have pushed deposit premiums up at a quicker pace from their 2009 lows, a trend that has continued through 2017.¹ The flattening yield curve that pushed CDI values lower in the third quarter of 2017 did not have the same effect on deposit premiums, but for deals closed in the third quarter deposit premiums largely reflected transaction values determined earlier in the year when the yield curve was steeper, and this lagged effect could push deposit premiums back down in upcoming quarters. Regardless of the near-term outlook, current deposit premiums in the range of 10% remain well below pre-financial crisis levels when premiums for whole bank acquisitions averaged closer to 20%.

Deposit premiums paid in branch transactions, defined as the value paid in excess of deposits acquired, have generally been less volatile than

¹ Deposit premiums paid in whole bank acquisitions are defined as the premium to tangible book value as a percentage of core deposits

Chart 2: CDI as % of Acquired Core Deposits

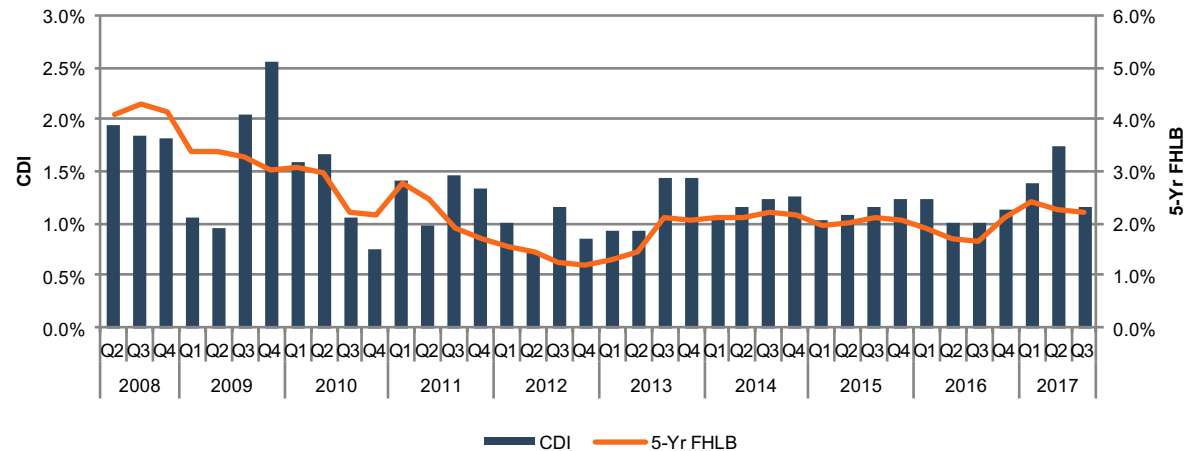


Chart 3: CDI Recorded vs. Deposit Premiums Paid

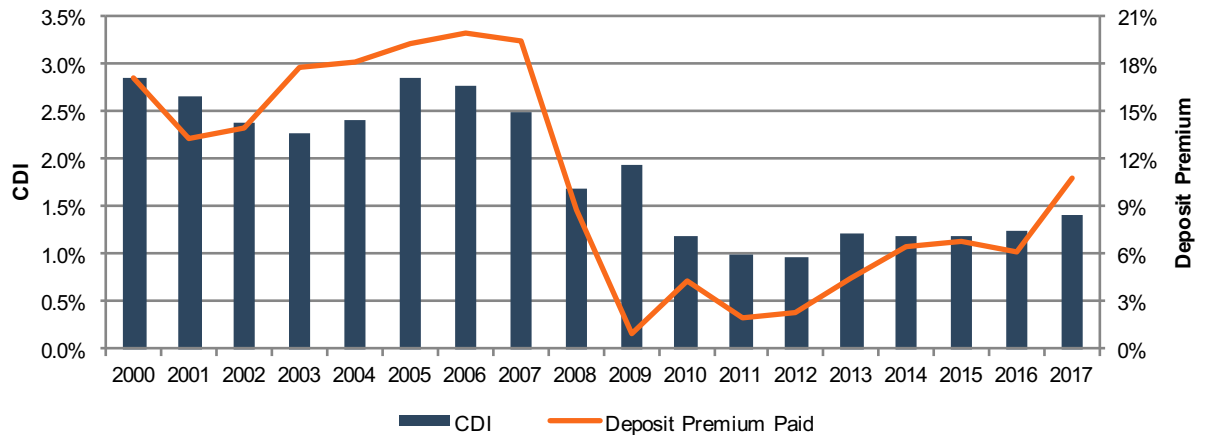
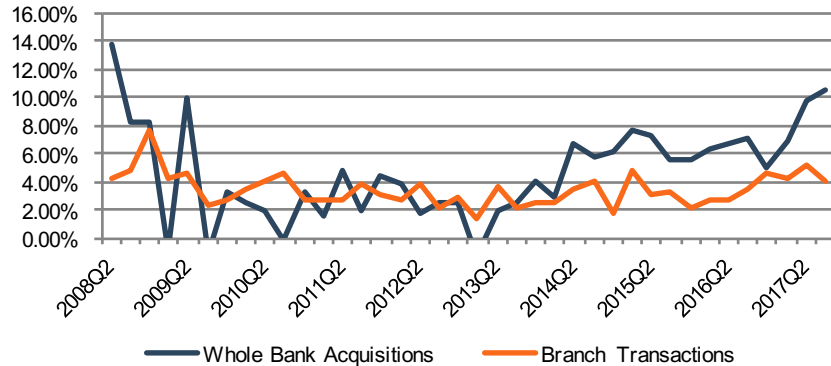


Chart 4: Average Deposit Premiums Paid

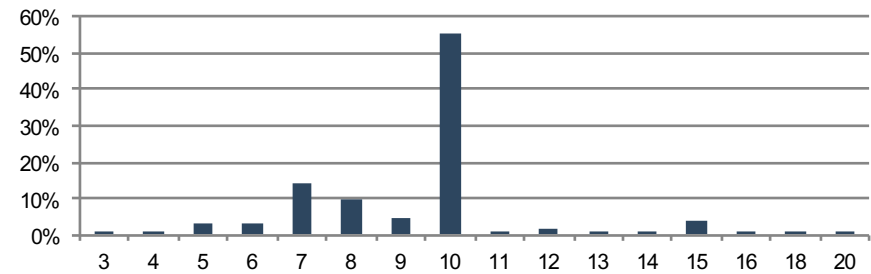


tangible book value premiums paid in whole bank acquisitions. Branch transaction deposit premiums are up some from the lows observed in the financial crisis, but have remained in the 4%–5% range for the last 12 months.

For our analysis of industry trends in CDI values, we defined core deposits as total deposits, less accounts with balances over \$100,000. In analyzing core deposit intangible assets for individual acquisitions, however, a more detailed analysis of the deposit base would consider the relative stability of various account types. In general, CDs tend to be more rate sensitive and less stable. Even in cases where a CD base is considered a stable customer base, given their relatively higher cost compared to non-time deposits, CDs often do not contribute to the core deposit intangible asset recorded. Furthermore, account types such as brokered or Qwickrate accounts and certain public funds that may be subject to a competitive bidding process are generally excluded from core deposits when determining the value of a CDI.

Chart 5: Selected Amortization Term (Years)

Transactions Completed 2008 - Sept. 30, 2017



What We're Reading

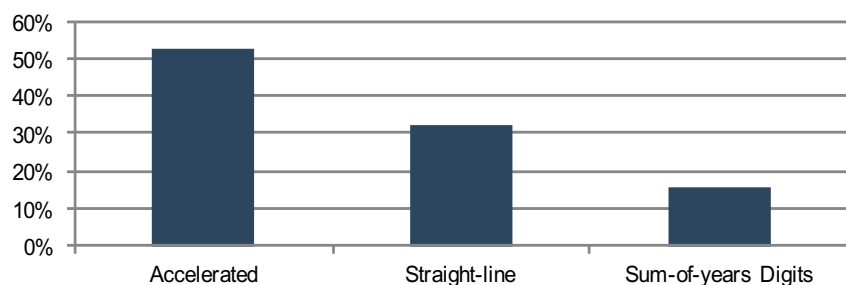
Stephen Ranzini (CEO & President of University Bancorp) has an interesting piece on *American Banker's BankThink* entitled: **[“Don't Let Community Banks Go from Endangered to Extinct.”](#)**

These two pieces discuss the future of banking and the potential impact of FinTech. The first examines FinTechs pursuing bank charters, and the second discusses how FinTech may impact bank M&A.

[Why The ICBA Doesn't Want Square To Be A Bank](#)
 PYMNTS.com

[How FinTech Will Change Bank M&A](#)
 Banking Exchange: Steve Cocheo


Chart 6: Selected Amortization Method



Based on the data for acquisitions for which core deposit intangible detail was reported, a majority of banks selected a ten-year amortization term for the CDI values booked. Less than 10% of transactions for which data was available selected amortization terms longer than ten years. Amortization methods were somewhat more varied, but the accelerated amortization method was selected in approximately half of these transactions.

For more information about Mercer Capital's core deposit services, please contact us.

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**First Southern
BANK**
FSB, LLC
Florence, Alabama

has agreed to acquire

**First Southern
Bancshares, Inc.**
Florence, Alabama

Mercer Capital served as
financial advisor & rendered a
fairness opinion on behalf of
First Southern Bancshares, Inc.

June 2017

**Learn More
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Advisory Services**

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Recent Transaction**

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

- Strategic consulting
- 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

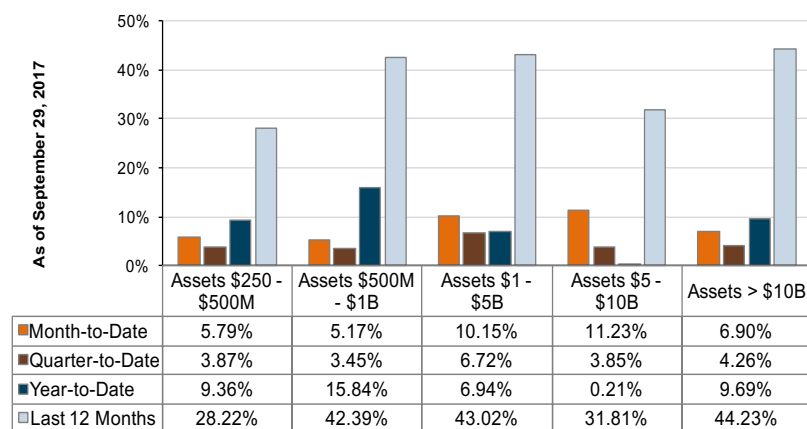
- Capital planning and consulting
- Branch transactions
- Regulatory-assisted transactions
- Bank stress testing

Mercer Capital's Bank Group Index Overview



Return Stratification of U.S. Banks

by Asset Size



Median Valuation Multiples

Median Total Return as of September 29, 2017

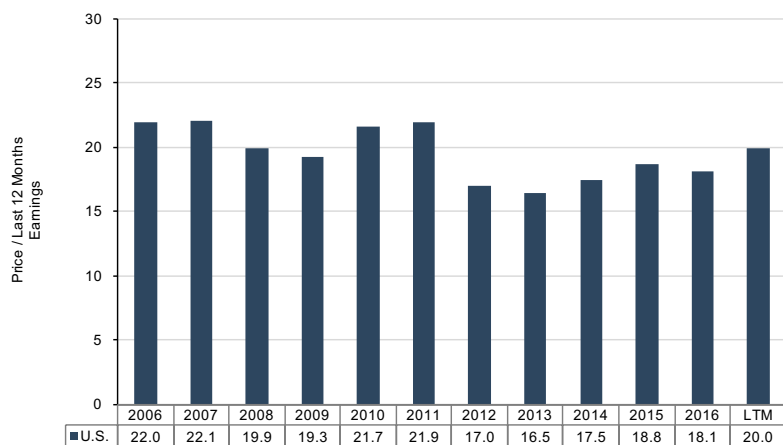
Indices	Month-to-Date	Quarter-to-Date	Year-to-Date	Last 12 Months
Atlantic Coast Index	8.53%	6.01%	14.99%	47.22%
Midwest Index	10.11%	7.42%	7.32%	41.64%
Northeast Index	10.68%	7.36%	8.71%	40.48%
Southeast Index	6.28%	2.25%	3.43%	32.78%
West Index	10.71%	8.84%	12.64%	52.74%
Community Bank Index	9.30%	6.29%	9.03%	42.70%
SNL Bank Index	7.15%	4.33%	9.21%	43.65%

Median Valuation Multiples as of September 29, 2017

Indices	Price / LTM EPS	Price / 17(E) EPS	Price / 18(E) EPS	Price / Book Value	Price / Tangible Book Value	Dividend Yield
Atlantic Coast Index	21.8x	19.5x	16.1x	152%	170%	1.7%
Midwest Index	18.5x	18.4x	15.9x	156%	170%	1.8%
Northeast Index	18.3x	18.1x	15.8x	154%	175%	1.9%
Southeast Index	18.4x	21.3x	18.4x	147%	155%	1.2%
West Index	18.0x	18.1x	16.5x	154%	162%	1.6%
Community Bank Index	18.8x	18.5x	16.1x	152%	168%	1.7%

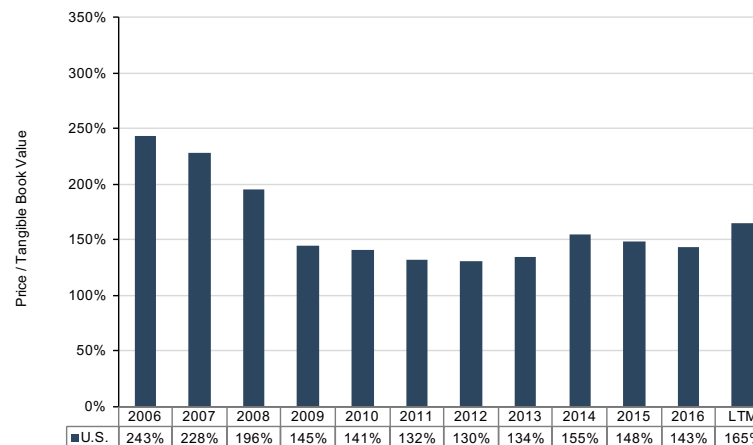
Median Price/Earnings Multiples

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



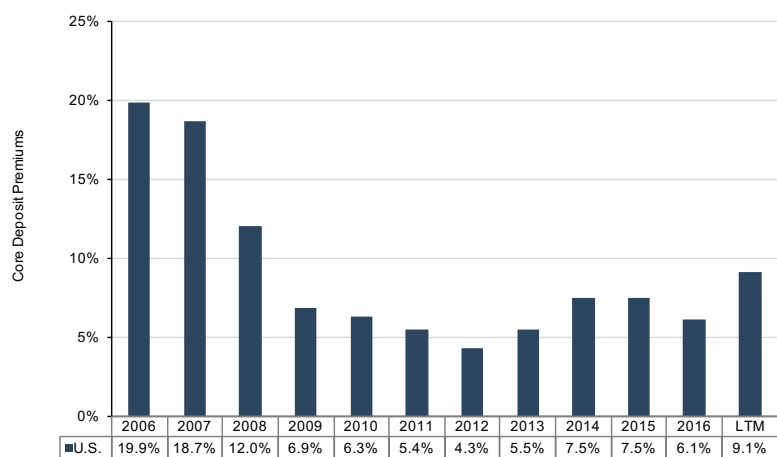
Median Price/Tangible Book Value Multiples

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

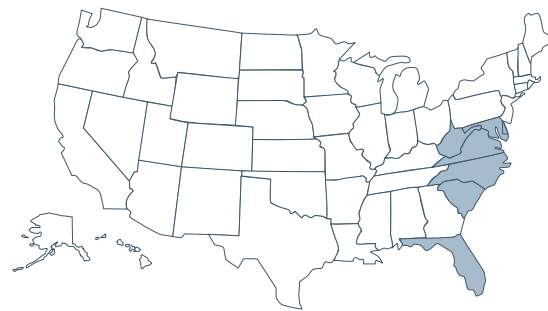
Target Banks' Assets <\$5B and LTM ROE >5%, 12 months ended September 2017

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	22.1x	168%	10.1%	24	104.28	490,323	7.50%
Midwest	19.7x	166%	11.7%	60	45.42	182,317	8.95%
Northeast	19.4x	158%	5.1%	9	56.96	488,060	7.45%
Southeast	18.2x	157%	7.3%	32	38.41	170,925	8.10%
West	23.1x	182%	8.8%	21	50.81	305,609	9.00%
National Community Banks	20.0x	165%	9.1%	146	50.69	250,011	8.52%

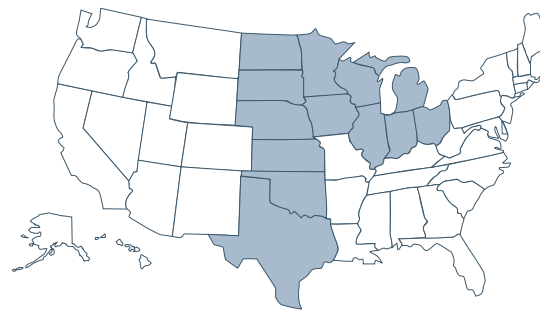
Source: S&P Global Market Intelligence

Mercer Capital's Regional Public Bank Peer Reports

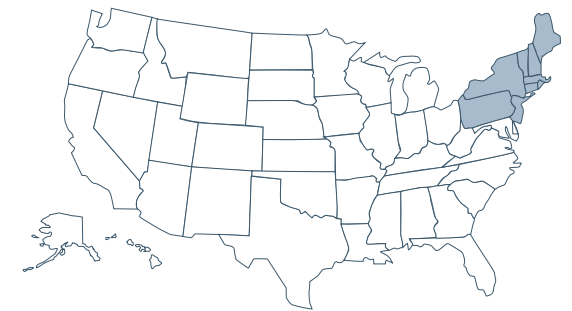
Updated weekly, Mercer Capital's Regional Public Bank Peer Reports offer a closer look at the market pricing and performance of publicly traded banks in the states of five U.S. regions. Click on the map to view the reports from the representative region.



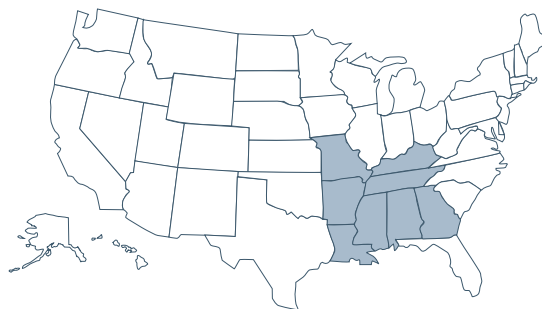
Atlantic Coast



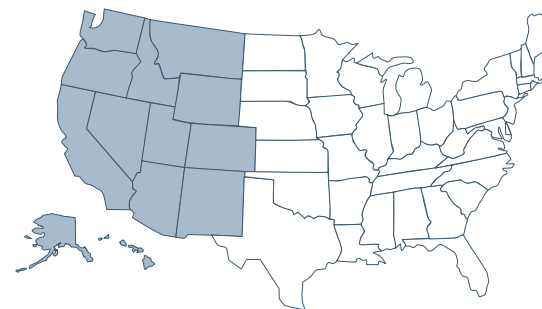
Midwest



Northeast



Southeast



West

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.

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

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