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Hancock Holdings and expectations

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On Nov. 14, Hancock Holding Co.announced that Carl Chaney would retire from his position as co-CEO of Hancock, effective at year-end. His service as president of the company and subsidiary Whitney Bank ended Nov. 13. He had held the co-CEO position with John Hairston since 2006. Hairston dropped the "co" qualifier for the CEO title and assumed Chaney's role as president of the company.

I do not know what the management and board-level dynamics were at Hancock, but the co-CEO executive structure has always seemed odd to me. I am sure there are some examples where the structure has worked, but it seems akin to polygamy to me without the benefits. Wall Street has seen a few co-CEOs. The one that comes to my mind is the early 1980s co-CEO duo at Shearson Lehman Brother of polished Pete Peterson, the banker, and street-fighter Lewis Glucksman, the trader. Apparently, these men hated each other. Glucksman won when Peterson was eventually ousted.

Chaney may have had enough of whatever issues there were; maybe the board was unsatisfied with the company's performance and held Chaney accountable; or, maybe Chaney made enough money to move onto other life interests after having spent years in banking and as a bank securities attorney.

My read on the management change at Hancock relates to how the Street operates around expectations.

I believe Hancock has a well-deserved reputation among Gulf Coast consumers and businesses as a conservative, well-managed bank that has supported the regional economy for many decades. Institutional investors, I think, have appreciated Hancock's history of consistent profitability and growth without a lot of risk taking. For example, Hancock never reported a quarterly loss in 2008 or 2009.

Historically, the company has grown during periods of industry turmoil. It expanded in Louisiana with the acquisition of a failed bank in 1990. It then acquired seven banks in the state during the 1990s as the banking system stabilized following a decade-long disaster that was precipitated by the collapse in oil prices during the 1980s. Hancock expanded in the Florida Panhandle when it acquired a small bank in Tallahassee that failed during 2004; it then acquired the larger Peoples First Community Bank of Panama City that failed in 2009. The seminal deal in Hancock's storied history occurred when Hancock and its once big brother, New Orleans-based Whitney Holding Corp., agreed to merge on December 22, 2010, in a deal that was valued at $1.5 billion.

My take on the Whitney deal is that IBERIABANK Corp. more or less put a weakened Whitney in play when the board probably was not looking to sell. Whitney turned to Hancock. Although the two companies were different, they knew each other well as long-time regional competitors. Also, the merger occurred in 2011 when Whitney's credit issues, which were mostly tied to Florida real estate, were nearing a peak while the Gulf Coast economy was benefiting from strong energy-related investment.

So what gives? Results for the latest twelve months are okay with an ROA, ROE and ROTCE of 0.89%, 7.0% and 11.1%. Capital and asset quality, two hallmarks of both Hancock and Whitney, are in good shape. Was the board (or Chaney) unhappy with the results of the Whitney deal? Maybe they were.

If the board and institutional investors had an issue with the performance of the shares, they have a point given the market's "bloodless verdict," as Double Line's Jeff Gundlach would say. The shares have produced a total return of 2% from Dec. 21, 2010, the day before the Whitney announcement, through Nov. 23, 2014, compared to 47% for the SNL U.S. Midcap Bank Index. Over the five-year period ended Dec. 21, 2010, Hancock produced a total return of 9% compared to negative 58% for the index, which speaks to how well Hancock performed in the downturn.

Expectations matter a lot when investing, at least over a short-to-intermediate time frame. A company that does not produce earnings that the Street expects usually will underperform its benchmark until performance improves and/or expectations decline. Likewise, the entry valuation matters. "Inexpensive" or "cheap" are not catalysts, but a low multiple entry typically provides downside protection and upside potential.

Hancock reported EPS of $2.26 in 2009, which included a $33.6 million pretax gain on the acquisition of Peoples First and $3.7 million of pretax merger expenses. Excluding the net gain, adjusted EPS approximated $1.70. During the first, second and third quarters of 2010, Hancock reported earnings of 37 cents, 17 cents and 40 cents per share; however, by the time the Hancock-Whitney merger was announced in December, the consensus was $2.38 per share for 2012 and $2.60 per share for 2013. With expense savings, the investor slide deck for the transaction showed the pro forma GAAP operating EPS to be $2.59 for 2012 and $3.10 for 2013.

On Dec. 21, 2010, the day before the deal for Whitney was announced, the shares closed at $37.04 per share. If one accepted the operating consensus EPS, the implied valuation was not especially rich at 14.2x pro forma 2012 consensus and 11.9x pro forma 2013 consensus. What was ridiculous was the base Street estimates for Hancock (and maybe Whitney too), in my view, given the earnings run rate headed into the announcement. Hancock then reported earnings of $1.40, $1.15, $1.75 and $1.93 per share for 2010, 2011, 2012 and 2013, respectively. Ex-charges earnings were higher, but that misses the point. Besides, tangible book value was $21.19 per share at year-end 2010; it was $21.44 per share on Sept. 30, 2014.

Had Hancock's shares been "cheap" when the deal for Whitney was announced, they probably would have performed better than they have, but that was not the case. Further, the Street's estimates were wide by a mile. Compounding the headwind has been the declining impact of asset marks that has produced accretion. Third-quarter earnings were 56 cents per share as reported and 49 cents per share on a "core" basis excluding accretion according to Hancock's release — i.e., a run rate around $2.00 per share.

No doubt some of the Street's exuberance for Hancock assumed short rates eventually would rise and push the company's NIM higher (it was 3.81% in 3Q14 as reported; 3.32% excluding accretion) and thereby lift EPS and offset the wind-down of accretion income. That has not happened. My view of Hancock in the years immediately after the crisis was that the Street was giving the company too long of a leash in terms of overlooking current results when estimating the out year's earnings potential.

The phenomenon may still exist given a FY15 EPS consensus estimate of $2.41 as of Nov. 21. Maybe the board, investors and management believed too much in Street estimates or "normalized" earnings because that narrative synced with history and justified the share price. My experience is that the Street will sometimes create unrealistic earnings expectations to justify the share price for a well-liked company even though the facts may not support the narrative. At a very basic level, maybe that is what happened with Hancock and Carl Chaney.

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