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Mississippi merging

By Jeff K. Davis

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A year ago I penned a post about Hancock Holding Co. and the role I believe inflated Street expectations played in what has been a woeful share performance for a well-run bank since the merger with Whitney Holding Corp. was announced. When the transaction was announced on December 22, 2010, the slide deck included pro forma GAAP operating EPS of $2.59 for 2012 and $3.10 for 2013. Hancock's earnings have not been remotely close to that level on a reported, operating or core basis. In fairness to the company, the numbers were based upon the Street's optimistic stand-alone estimates for Hancock and Whitney and the projected expense savings.

This has not been a great year either with the shares down 5.8% through April 24; however, the shares may be bottoming now that the Street seems to have figured out the limited life impact of purchase accounting accretion — a non-cash item that would not be counted in any other industry. Hancock reported Q1'15 operating EPS of 55 cents, core EPS of 49 cents (operating EPS less purchase accounting adjustments) and GAAP EPS of 49 cents. Management indicated in the release that the issue will be rendered moot because core and operating results will be "essentially the same in the second half of 2015."

CFO Mike Achary noted that Hancock's current modeling indicates 2016 core net income, which excludes purchase accounting accretion, is tracking toward 25% over 2014 core net income of $1.90 per share (vs. $2.10 per share as reported). As of April 24 the 2016 consensus was $2.49 per share compared to $2.38 per share as implied by the comment. That is close enough, but stocks with rising EPS estimates or low multiple stocks with a catalyst are typically shares with better than average upside potential. In any event, it seems what has been nearly five years of a wide gap between the Street's forward expectations and reported EPS that could have been papered over by Fed rate hikes given a very asset sensitive balance sheet is coming to an end.

Instead of the accretion calculus, what got my attention during the call was management's comments about its preference to use capital for M&A over buybacks beyond that which is absorbed by organic loan growth and the dividend. If the current earnings run rate is about $2.00 per share then it is hard to argue the shares are a great bargain at 14x for repurchases. Conversely, I agree with Achary that smallish deals in which the target has $1 billion to $3 billion of assets may be a good use of capital to leverage the infrastructure and boost earnings — provided Hancock does not overpay — because execution risk should be modest for small deals.

One does not have to use too much imagination regarding what banks fit that bill in and around a franchise that is concentrated along the I-10 corridor in Mississippi, Louisiana, Florida, Alabama and Texas. There are not that many banks in the $1 billion to $3 billion range. During the past year I have heard increased talk among Mississippi bankers about a possible deal with Trustmark Corp. Investor support for another quasi-MOE involving Hancock (its market cap as of April 24 was $2.4 billion vs. $1.6 billion for Trustmark) probably would be nil.

Although its year-end asset base of $5.8 billion is outside the targeted range, I wonder about Tupelo, Miss.-based Renasant Corp. The company has outperformed its Mississippi peers since the financial crisis occurred by producing good returns, executing a series of accretive acquisitions and having avoided cutting the dividend or raising common equity to rebuild capital (a 2010 raise occurred in conjunction with the acquisition of a failed bank). Renasant's shares have produced a five-year total return of 114% through April 24 compared to 7% for Trustmark, 17% for BancorpSouth Inc. and negative 21% for Hancock. Louisiana-based IBERIABANK Corp.'s five-year total return was 12%, while the respective total returns for SNL's Small Cap and Mid Cap U.S. Bank indices were 49% and 32%. The market's bloodless verdict is that Renasant clobbered its regional competition. Aside from avoiding unmanageable credit issues, Renasant's outperformance is partially attributable to its highly EPS accretive acquisition of First M&F Corp. that helped push its shares up 54% in 2013.

Whether Renasant's pending acquisition for Georgia-based Heritage Financial Group Inc. will be as successful remains to be seen. It is a market extension transaction rather than what was largely an in-market deal for First M&F. The investor slide deck notes that "double digit EPS accretion (is) projected in 2016" and "tangible book value dilution is expected to be earned back in less than two years." The 2015 and 2016 consensus estimates for Renasant are $2.10 per share and $2.43 per share, compared to $1.88 per share reported in 2014.

It may seem odd that I bring up Renasant because it is outwardly an unlikely candidate to merge with Trustmark, Hancock, IBERIABANK or any other bank given the outperformance of its shares, improving profitability and good strategic position. The first bullet in a recent presentation says as much: "focus on highly-accretive acquisition opportunities."

However, there are reasons to view a merger as possible too. Like every other bank, the company faces earnings pressure. The net interest margin was 4.12% in 2014 according to SNL. Declining accretion from past acquisitions and intense pressure on loan yields ensure, I think, the NIM in time will drift much lower even though some of the company's lending markets such as Mississippi may provide better pricing vis-à-vis such markets as Nashville. Trustmark's NIM was 3.86% in Q4'14 as reported and 3.54% excluding purchase accounting adjustments.

Also, if Renasant CEO Robin McGraw, who is 68, does not have a successor that the board fully supports then merging with Trustmark, Hancock, IBERIABANK or another bank could address the issue. Finally, Renasant has an attractive footprint that offers both overlap where cost saves could be sizable and, depending upon the partner, market extensions into Alabama, Nashville, east Tennessee, Georgia and Florida.

If Renasant were to partner with another bank, it would be from a position of strength unlike the weakened Whitney that was pushed into seeking a combination with Hancock by IBERIABANK. Maybe a transaction would be too much for institutional investors who have suffered as Hancock owners. Renasant is still a small cap company by market cap conventions, but its pro forma market cap of about $1.2 billion inclusive of Heritage is material in relation to Trustmark ($1.6 billion), Hancock ($2.2 billion) and IBERIABANK ($2.4 billion).

Farfetched or not, Mississippi is comparable to Alabama a decade ago when a combination of rich acquisition pricing, the ability to obtain synergies, succession issues, and desirable footprints led to the acquisition of AmSouth Bancorp., Alabama National Bancorp., Compass Bancshares Inc., and SouthTrust Corp. No doubt the management of Colonial BancGroup Inc. wishes they were part of that list too. Beyond having what I believe is a correct thesis that loan yields and NIMs are headed much lower than the Street envisions, I may have Mississippi backwards. Maybe it is Renasant that will be the lead in consolidating the state.

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