NASHVILLE NOTES

Revisiting Carl Icahn's view of CIT

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The pending merger of First Citizens BancShares Inc. and CIT Group Inc. has been a homerun in the three weeks since it was announced before the market opened Oct. 16. First Citizens' shares rose 41% from Oct. 15 through Nov. 6 compared to a gain of about 5% for the SNL Mid Cap U.S. Bank Index.

CIT's shares are up 62% in that same period, with only 11% of the move attributable to the day one premium. Value investing is not dead apparently. Ben Graham, the father of value investing and author of *The Intelligent Investor*, probably would approve (he died in 1976) because the modest valuation implies a margin of safety exists for First Citizens provided the economy does not hit another air pocket.

Some around Wall Street may have had an inkling that the merger of the two was in the works, but I did not. This is one of the most opportunistic bank combinations that I can remember since JPMorgan Chase & Co. acquired Bear Stearns.

From a numbers perspective, it is not hard to see what has propelled First Citizens shares since it agreed to a share exchange that will result in CIT shareholders owning about 39% of the combined company.

First Citizens' shares were trading at 108% of tangible book value and 8.6x trailing 12-month earnings Oct. 15 compared to CIT's shares that were valued at 44% of tangible book value (CIT's trailing earnings were negative) based upon the announced deal value.

A premium valuation for the acquirer combined with expense savings (~10% of the combined company's expense base) equates to sizable accretion upwards of 50% for EPS and 30% for tangible book value. For a typical bank in an average economy it easily could take years to produce comparable EPS and TBVPS growth.

In a sense the decision by CIT's board to merge with First Citizens is an acknowledgement that Carl Icahn was right a decade ago about the company's prospects.

In October 2009, Icahn backed a pre-packaged bankruptcy of CIT that handed ownership of the company to creditors. CIT obtained $2.3 billion of TARP capital in 2008 but faced a liquidity crisis a few months later because it had limited deposit funding and could not secure sufficient new financing with most assets funded outside its then small industrial bank.

My recollection when I covered the stock as a sell-side analyst is that Icahn said something to the effect that he did not think CIT's prospects from a shareholder's perspective were that good, perhaps due to the lack of low cost deposit funding. During the first quarter of 2010 Icahn sold his entire 12 million share position that he obtained from the bankruptcy reorganization.

On Dec. 10, 2009, the first day of trading when CIT emerged from bankruptcy, the shares opened at $25.50 and ended the year at $27.61 per share. By March 31, 2010, the shares had climbed to $38.96 per share. Icahn sold the shares in this band, netting a sizable profit from his investment in the pre-bankruptcy bonds. CIT's shares then spent the next 9 years and 10 months mostly trading in a range of roughly $35 to $50 per share.

The shares crashed to a closing price low of $13.43 per share on March 23 at the peak of the COVID-19 market panic. CIT shares subsequently rebounded somewhat and closed Oct. 15 at $19.74 per share, and were valued at $21.91 per share on the morning of October 16 when the deal was announced based upon First Citizens' share price and the 0.062 exchange ratio.

The history validates Icahn's decision to sell his CIT shares, but it does not speak to the future today.

First Citizens has a long history as a successful acquirer, but this is a large transaction that does not involve a community or regional bank. Execution risks are not immaterial. The acquisition of CapitalSource by PacWest Bancorp is the closest comparison. The Street's view of that transaction is, I think, mixed.

Nonetheless, I think there are several reasons a transformative merger potentially may be a big winner for First Citizens beyond the outsized returns realized since announcement.

One is ownership. The Holding family has been long-time successful bankers in the Carolinas. The family will be by far the largest shareholder in the pro forma company and would not enter in a transaction without high conviction that the merger makes financial and strategic sense.

Also, the timing looks to be excellent absent a deep recession in the next few years because the market has taken a punitive view of CIT's loan portfolio given where the shares were trading immediately prior to announcement. Had the merger been announced a year ago, then the ownership might have been closer to 55%/45% rather than 61%/39% based upon the market caps.

The larger strategic rationale addresses an issue all lenders face today: yield and asset origination opportunities in a zero-rate, muted growth environment. CIT's commercial asset origination business offers more opportunities to lend First Citizen's low-cost deposits with greater diversification and potentially better risk-adjusted yields than a typical regional bank with a heavy concentration in CRE loans.

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