

NASHVILLE NOTES

## Another Memphis banking milestone

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My prior Nashville Notes post was about how the pending sale of First Horizon Corp. to TD Bank Group represented the end of large Memphis, Tenn.-based banks. This post is an addendum.

Tom Garrott, the long-time CEO of Memphis-based National Commerce Financial Corp. that SunTrust Banks Inc. acquired in 2004, passed away on March 30. Garrott was a pioneer in supermarket banking, perhaps because he was CFO of food distributor Malone & Hyde before becoming president of National Commerce's banking subsidiary in 1982. National Commerce at one point had over 100 supermarket branches and generated additional fee income from providing consulting services to other banks who would open supermarket branches.

I first saw Garrott when he spoke to my corporate finance class in business school at Vanderbilt in 1987. I remember two things he said. One was that National Bank of Commerce did not hire MBAs generally, but it did hire VBAs — verbal, bright and articulate young people who were good candidates to recruit new customers. Two of his VBAs are CEOs of Nashville banks today: Chris Holmes of FB Financial Corp. and Jim Rieniets of InsCorp Inc.

His other comment had to do with bank performance and shareholder value. When Garrott became president of the banking unit in 1982, it was an underperforming commercial bank with a limited consumer business that I think was struggling with the lingering effects of the brutal 1981 recession. He said that if a bank could not produce a return on equity at least equal to what it pays on certificates of deposit then it should be liquidated — implying shareholders would be better off if the proceeds were then invested in low-risk CDs.

In the spring of 1987, the rate on a one-year CD was 6-7%, an unimaginably high rate by today's standard. I do not know if his ROE standard was the then one-year CD rate or if his reference was a few years earlier when he became president when rates were roughly double 1987 but still below the 1980-1981 cycle peak.

Garrott and his management team transformed the underperforming bank into a high performing company that produced high ROEs and EPS growth most years. During the 1990s, the company's ROE ranged between 17% and 21% each year. The returns were generated for the most part through organic growth supplemented with small acquisitions, operating leverage in the bank, and multiple nonbank subsidiaries that included institutional fixed income, asset management and card payment processing for trucking companies.

In 2000, the company entered into a merger of equals with Durham, N.C.-based CCB Financial Corp. Maybe the rest of Wall Street was not surprised by the merger, but I was. I covered both companies for Nashville-based J.C. Bradford & Co. but never considered the two as merger partners.

I think it was a year or so later when Garrott told me why the board entered into an MOE with a company that they did not know that well. He said that a particular investment banker that carried weight with banks told him that if the company ever hoped to command a superior valuation in an acquisition that it needed a bigger retail presence. CCB primarily added market share in the Carolinas, which was then an attractive market as it is today.

I do not remember the particulars about the conference call but as soon as the call ended National Commerce's CFO, Lewis Holland, called me. In so many words he said that while Garrott would relinquish the CEO and chairman titles to CCB's Ernie Roessler, Tom as chair of the executive committee could fire Ernie if need be "though it will cost \$10 million."

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In theory there should have been a honeymoon when the two companies combined based upon returns. The merger of National Commerce and CCB produced returns on tangible common equity of 24%, 30% and 25% during 2001-2003. Nonetheless, Roessler announced his retirement in May 2003, and the second-quarter 2003 earnings release included a \$9.2 million after-tax charge for Roessler.

In 2004, SunTrust and Fifth Third Bancorp competed to acquire the company. The story I heard was that Garrott wanted the company sold to Fifth Third, in part because he was impressed by the company's financial performance. Maybe there was a common bond with The Kroger Co., which was based in Cincinnati too, and hosted many in-store branches. SunTrust was a better geographic fit, and the company needed the presence in the Carolinas after it lost the battle for legacy Wachovia Corp. to First Union Corp. a few years earlier.

The unnamed investment banker spoke the truth. The SunTrust acquisition valued National Commerce at announcement on May 7, 2004, at \$7.4 billion, 4.5x tangible common equity and 21x trailing 12-month unadjusted earnings. The price/tangible book value multiple speaks to how much higher the industry's ROTCE was before the Great Financial Crisis when the U.S. still had meaningful interest rates, though 21x the company's strong earnings also says something about the value the company commanded.

A final vignette. Garrott was known to have a temper at times. I only saw it once. During a visit to his office in the fall of 1999 he was flipping through the Best Ideas publication from J.C. Bradford & Co. where I was then the regional bank analyst. He told me the only stock that interested him was a parking lot REIT (I was not quick enough to ask him about local competitors First Horizon Corp. or Union Planters Corp.). I said "sure" even though someone else covered the stock. The company preannounced in December.

I happened to be in Memphis and had a visit scheduled a couple of days later. At least for the moment I was not considered a VBA. After Garrott asked me — using very colorful language — how could it blow up when its business model was based upon collecting rents, he told me he bought more. I always suspected he did so through competitor Morgan Keegan's desk because he did not double down through our desk

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