SNL Blogs

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First Financial Bancorp sells-off, too

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Maybe it's because I am around the M&A market too much that I am missing something obvious. I was surprised by the 8.5% sell-off in First Financial Bancorp.'s shares on July 26 following the announcement that it will acquire MainSource Financial Group Inc. The transaction was valued at $1.0 billion based upon the closing price of First Financial's shares on July 25. I had a similar post a few months ago about the sell-off in Sandy Spring Bancorp Inc.'s shares following the announcement that Sandy Spring will acquire WashingtonFirst Bankshares Inc. I was less surprised by the market's reaction to Valley National Bancorp's acquisition of Florida-based USAmeriBancorp Inc. in which Valley's shares fell 6.3%, but that is a subject for another post.

The market presumably did not like the pricing for MainSource, which equated to 22.4x LTM earnings, 19.4x core LTM earnings and 266% of tangible book value, according to SNL's calculations. Are those rich multiples? If the transaction was a cash purchase, then the multiples would be rich before factoring in the target's growth prospects, synergies and other strategic benefits. However, the deal is structured as a stock swap, and First Financial's shares trade at multiples that are comparable to the acquisition multiples at 18.6x LTM earnings and 260% of tangible book value as of July 25. What is not rich to me and is in the middle of the fairway is the P/E of about 12x pro forma LTM core earnings inclusive of the projected expense savings.

The relative financial metrics look okay, too, though I suppose one could argue the exchange ratio could be tweaked lower in First Financial's favor given the market's reaction to the deal. MainSource will own 37% of the pro forma common shares, while it will contribute about one-third of loans, deposits and LTM net income based upon June 30, 2017, financials. This is largely an in-market deal that provides for consolidation of upwards of 50 offices; so it offers significant cost saves (36% assumed). Based upon estimated 2018 earnings and assuming all cost saves are phased-in, the pro-forma earnings split is 31% for MainSource, 54% for First Financial and 14% attributable to the cost saves. On that basis, the exchange ratio appears to be reasonable.

The per-share impact looks okay too with about 5% dilution to First Financial's tangible book value per share and an earnback period of three years, while EPS accretion is projected to be 9% once expense saves are fully phased-in and earnings are dinged for the impact of Durbin being triggered.

There could be other factors at play with the sell-off. Perhaps investors had pegged First Financial as a seller; or, maybe investors were put-off by elements of the second-quarter earnings release, which included a 14-basis point reduction in the reported NIM to 3.56%.

If the market sell-off is a reflection of execution risk, that would be harder to dismiss. This is a big transaction for both companies. The success or failure of any transaction — especially large ones — rides on execution. Bad execution can make great deals bad; and great execution can make deals that are not as compelling good. Both companies are experienced acquirers, so maybe execution risks are not as great as they appear. Nevertheless, if management fails at execution there will be no hiding it given the size of the transaction as would be the case with a small deal.

The combined company will have the advantage of more scale, while its focused geography and larger size should enhance value if the board decides to sell the company one day absent an asset quality fumble. That attribution combined with ~9% EPS accretion down the road may not assuage investors who were long First Financial before the announcement. In saying that the deal looks fine in the context of a stock swap, I am not advocating an approach to dealmaking that is analogous to central bank buying of bonds (and equities) in which the central banks do not care about value. Price paid matters a lot; it is the one variable any investor or corporate acquirer has absolute control over. However, value here is as much if not more about relative rather than absolute value.

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