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Goldman's asset moving business vs. Signature Bank's storage business

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One of many adages attributable to Wall Street is that securities firms are in the moving business while commercial banks are in the storage business. Brokerage firms make money trading assets for clients as an agent or trading for their own account as a principal, something that has been banned (theoretically) by brokers that are owned by a bank holding company (or bank) with the advent of the Volcker rule. Lackluster trading results posted by Goldman Sachs Group Inc. and other banks in recent years point to which type of trading has better margins.

Commercial banks make money by holding loans and bonds on their balance sheets. Allegedly it is a boring business. Whether the moving or storage business, assets have to be financed. Brokers rely upon repurchase agreements and commercial paper, while commercial banks rely upon customer deposits.

The financial press this past quarter has been filled with stories about how the moving business is just not what it used to be and that Goldman's revenue mix especially is not well-suited for the post-financial crisis environment. Goldman's return on common equity for the last-12-months ended June 30 was 10.7%, compared to an average of 24.4% for 2003 through 2007, according to SNL Financial. Regulators and fixed income investors who purchase Goldman's debt instruments might retort that the business model now is a lot less risky than the precrisis years and that equity investors should be happy with a double-digit return on equity. Not surprisingly, Goldman's equity investors and management are not pumped about current returns.

Goldman executives have been making a case with Wall Street that the company has a three-year opportunity to add up to $5.0 billion of net revenues, which includes $2.0 billion attributable to "firm-wide lending and financing efforts." Firm-wide lending and financing can include a lot of things, but the short-hand appears to be more storage revenues.

Goldman is of course in the storage business already. Brokerage firms extend credit to clients in the form of margin lending, or they may lend securities. Goldman is a player in the syndicated loan market. Goldman even has a bank, Goldman Sachs Bank USA, which had $151 billion of assets, $51 billion of loans and $106 billion of deposits as of June 30. It is a substantial entity in the context of Goldman's $907 billion of consolidated assets.

No doubt with focus and perhaps more aggressive pricing Goldman can grow its storage business, but it probably will be a slow proposition absent excessive risk taking that could produce outsized credit losses at a later date. Alternatively, an acquisition could speed the process if the right target is identified and is willing.

An interesting, if perhaps somewhat far-fetched, way to remix the revenues would be to acquire New York-based Signature Bank. Signature has been one of the great successes among U.S. commercial banks since it was established in 2001 and completed its IPO in 2004. The business model is simple: grow share in the greater New York market by hiring the best bankers who are disenchanted working at mega banks. As of June 30, assets, loans and deposits respectively totaled $41 billion, $31 billion and $33 billion, none of which was acquired through the acquisition of another bank. Further, Signature is not a retail-focused bank. Most of its 31 offices have well over $100 million of deposits. Signature grew earnings during the financial crisis then saw its stock rise sharply in the years after the crisis as earnings continued to climb; however, Signature has hit a rough spot lately, primarily because of heavy provision expense incurred in the third quarter of 2016 and second quarter of 2017 for its taxi medallion loan portfolio. While disappointing, Signature is not in the ditch; its LTM ROCE declined to 9.3%, compared to over 13% during 2013 through 2015.

The shares, which have produced an exceptional return for shareholders when viewed from a long-term perspective, have underperformed this year since early March when the shares traded at around $160 per share. Last week, the shares fell sharply on Sept. 12 and Sept. 13 to under $120 per share after management offered subdued guidance at an investor conference in the form of limited loan and deposit growth and 3 to 6 basis points of net interest margin pressure. Growth stocks have to be fed growth to maintain growth multiples; the shares have responded accordingly to the recent results.

During the Q&A session of the investor conference, Signature President and CEO Joseph DePaolo offered the possibility that if Signature were to sell it probably would partner with a bigger bank that has little activity in the U.S., an interest in using deposit funding for some activities that may be funded with wholesale funds presently, and the capital to grow Signature nationally. The Street picked up on a foreign-owned bank (Signature was once owned by Israel-based Bank Hapoalim BM), but it seems to me Goldman could be a worthy suitor, too, if the board chooses that route. Whereas Signature employees and management might chafe at being acquired by a large U.S. bank, Goldman probably would be viewed as a different proposition.

Goldman could easily scale Signature's operations, and I suspect would find its deposit gathering infrastructure related to corporate treasury especially valuable by tying Goldman closer to its corporate banking clients. Plus, I think it is important to note that the loan syndication market where Goldman is heavily involved has functioned as a capital markets business for two decades even though loans are not securities from a legal perspective. Syndicated loans are marketed, distributed in the primary market or retained on the underwriters' balance sheet, and traded in the secondary market. That is not Signature's core business, but Goldman could leverage Signature's deposit gathering to increase its corporate banking business while expanding Signature's traditional middle market lending to more markets.

What could Goldman pay for Signature? A lot, and I suspect Goldman's board would like the idea of acquiring a great bank that is not trading anywhere near its 52-week high. Signature is small relative to Goldman; its market cap as of Sept. 15 was $6.5 billion, compared to $87 billion for Goldman. Perhaps the Fed would welcome such an acquisition by Goldman to lessen its moving business provided Goldman does not have a regulatory impediment.

Who knows? It is just speculation on my part that does not seem that far-fetched on my notepad. Maybe I am missing something obvious.

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