

NASHVILLE NOTES

# Share issuance matters too for JPMorgan

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*The Wall Street Journal* ran a story in late December 2019 about a humble retail investor who purchased 100 shares of Bear Stearns common stock on March 14, 2008, for \$30 per share, betting the troubled investment bank would be taken over at a higher price. Eleven years later the value of the JPMorgan Chase & Co. shares received in the merger had risen sufficiently that the investor was "even." The article noted CEO Jamie Dimon's stake in the company had risen to \$1 billion (\$1.1 billion according to S&P Global Market Intelligence as of year-end compared to \$209 million a decade earlier).

There's a lot to unpack in the article and when contemplating the performance of JPMorgan's shares since the financial crisis, not all of which is obvious.

Timing matters a lot when investing in equities and for acquirers. Sometimes, it really matters. Bear Stearns was forced into a shotgun merger with JPMorgan over the weekend that valued the seller at \$2 per share Monday morning March 17, 2008, based upon an exchange ratio of 0.05473. A week later JPMorgan agreed to increase the exchange ratio to 0.21753, which equated to \$10 per share with JPMorgan valued near \$46 per share. Had the investor bought Bear shares immediately after the Monday morning announcement, he might be able to brag about a "six-bagger" had he managed to buy around \$5 per share.

Company (ticker)	LTM EPS		TBV per share		LTM common dividends declared per share		Common shares outstanding	
	Q3'19 (\$)	Change from Q4'07 (%)	Q3'19 (\$)	Change from Q4'07 (%)	Q3'19 (\$)	Change from Q4'07 (%)	Q3'19 (B)	Change from Q4'07 (%)
Bank of America Corp. (BAC)	2.70	-17.9	19.18	42.8	0.63	-73.8	9.08	104.6
Citigroup Inc. (C)	7.53	11.7	69.03	-44.9	1.86	-91.4	2.18	337.1
Goldman Sachs Group Inc. (GS)	22.35	-9.6	212.37	139.7	3.70	164.3	0.36	-8.5
JPMorgan Chase & Co. (JPM)	10.13	133.9	59.72	171.2	3.30	123.0	3.14	-6.9
Morgan Stanley (MS)	4.69	61.7	39.67	60.5	1.25	15.7	1.62	53.7
Wells Fargo & Co. (WFC)	4.63	94.5	34.07	232.3	1.84	55.9	4.27	29.5
<b>Median</b>		<b>36.7</b>		<b>100.1</b>		<b>35.8</b>		<b>41.6</b>

Data compiled Jan. 3, 2020.  
LTM = last 12 months  
Analysis includes select U.S. public financial institutions with market capitalizations greater than \$75 billion at the end of 2019.  
Source: S&P Global Market Intelligence

Although not stated in the article, I suspect investors who bought Bear Stearns in early 2008 assumed its \$77 tangible book value per share and \$1.52 per share of earnings as reported for the fiscal year ended November 2007 were not so impaired as to render a \$30 per share entry price unreasonable. Of course, Bear Stearns was cheap for a reason — it faced an existential liquidity crisis.

The Bear Stearns purchase illustrates why some banks vastly outperform peers when measured over long periods of time. Although JPMorgan stock would trade as low as \$16 per share in March 2009, it has risen over three times since March 2008 to close at \$139.40 per share as of year-end 2019.

The obvious takeaway — as always — is to avoid big losses. The banking model is about making good and occasionally very good money on a consistent basis. There is no way to overcome large losses absent lucking out on an equity

investment that turns out to be spectacular in the future. There are few such examples among banks.

The second takeaway is to acquire weakened competitors cheaply as JPMorgan, Wells Fargo & Co. and PNC Financial Services Group Inc. did in 2008.

Even more important is to avoid having to raise sizable amounts of equity capital — especially at very low prices. JPMorgan raised common equity in September 2008 to coincide with the acquisition of Washington Mutual and then again in June 2009 when healthier banks returned to the market to pad capital and demonstrate that U.S. capital markets had reopened to them. As a result of limited issuance during the crisis and heavy buyback activity in recent years, JPMorgan's common shares outstanding have declined 6.9% to 3.1 billion as of Sept. 30, 2019, from 3.4 billion at year-end 2007. Yet the company acquired significant "earning" assets in Bear Stearns and Washington Mutual.

JPMorgan's share count stands in contrast to Citigroup Inc., where common shares have increased 337% since year-end 2007 and were 507% higher as of year-end 2013 before buyback activity picked up. Worse for Citigroup is that the explosion of shares did not coincide with the purchase of income-producing banks or businesses; it was pure dilution. That said, Citigroup's shares have been a great investment since March 2009, but timing matters here too.

Bank of America Corp. falls between the two. Its common share count has increased 105% since year-end 2007, but the company acquired Merrill Lynch & Company in late 2008. At the time Merrill did not seem like an earning asset due to toxic assets that were losing value, but the acquisition added a top retail broker and greatly strengthened Bank of America's capital markets and investment banking units.

Bear Stearns remains a somewhat controversial deal. CEO Dimon has been quoted as saying that given the chance again he would not do the deal because of the fines paid attributable to Bear's pre-acquisition actions and subsequent damage to JPMorgan's reputation. Besides, many Bear Stearns employees and clients probably would have migrated to JPMorgan anyway had it been forced to file bankruptcy like Lehman.

Dimon has showed good timing too when acquiring JPMorgan shares. He made open-market purchases of roughly 500,000 shares three times: January 2009, July 2012 following the London Whale fiasco, and January 2016 when the global economy appeared to be headed for recession. Today, his 1.5 million shares are worth over \$200 million and produce about \$5 million of dividend income.

In contrast to the ill-timed purchase of Bear Stearns shares cited in the *WSJ* article, the purchases by JPMorgan and Dimon suggest an old Wall Street saw — bought right is half right.

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