MERCER CAPITAL

Bank Watch

November 2014

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Bank Watch

Return of the Large and Super Regional Buyers?

It is sort of like the pre-crisis days, but not really. Bank acquisition activity involving non-assisted transactions has been gradually building since the financial crisis. The only notable interruption occurred in the second half of 2011 when the downgrade of the U.S. by S&P (but not Moody's or Fitch) and a funding crisis among many European banks caused markets to fall sharply.

As of November 14, 260 bank and thrift acquisitions had been announced this year according to SNL Financial, which compares to 246 deals for all of 2013. Pricing continues to gradually improve too. The year-to-date average P/TBV is 135% compared to 120% in 2013 and 116% in 2012. In a sense, a declining median P/E points to higher valuations because sellers as a group are posting better profitability than several years ago. The median P/E ratio this year is about 28x compared to 23x in 2013 and 34x in 2012. Figures 1 and 2 on page 3 highlight some of these comparisons for deals both in 2014 and from 2009-2013. Although it will be a subject for a later post in *BankWatch*, we believe most buyers are paying roughly 10-13x the buyer's normalized earnings with after-tax cost saves and normalized credit costs.

The heyday of M&A activity for investors was the 1990s when over 500 bank and thrift deals were announced in 1994 and 1998. Deal activity peaked last decade at 323 in 2007. Not coincidentally, cycle peaks in public market bank valuations occurred near the peaks in M&A activity in 1998 and 2007. When viewed as a percent of banks at the beginning of each year, deal activity has been relatively steady with 3-4% of banks being absorbed through acquisition, with the exception of 2008, 2009 and 2011.

One notable aspect of the bank M&A market since the financial crisis has been the absence of larger acquirers other than periodic deals. The primary reason cited has been regulatory challenges as large banks implement tough compliance requirements as part of Dodd-Frank and other regulatory mandates that emerged from the 2008-2009 financial crisis. Also, many bankers and corporate securities attorney have publicly commented (and to us) that the Fed does not want to see merger applications from the largest banks; rather, they want consolidation to occur from the bottom rather than the top of the industry.

M&T Bank Corporation (MTB) remains the poster-child for the industry in terms of what can go awry with a merger application when a compliance issue emerges. M&T announced a deal to acquire then $44 billion asset Hudson City Bancorp on August 27, 2012 for $3.8 billion as shown in Figure 2. Over two years later the deal remains pending due to compliance issues that emerged for M&T, including some issues related to its 2011 acquisition of Wilmington Trust Corporation. Although on a smaller scale, BancorpSouth (BXS) recently extended by about a year the date of two definitive agreements it had entered into to acquire community banks in Louisiana and Texas due to compliance issues that emerged after the definitive agreements were signed.

CEO Richard Davis of US Bancorp (USB) has opined that acquisitions by larger banks will be episodic and focused like USB's acquisition of Citizen Financial Group's Chicago franchise earlier this year rather a broad-based trend. Nevertheless, the return of BB&T Corporation (BBT) to the acquisition market this year may signal larger banks are becoming more comfortable with their regulatory standing to resume acquisitions. In late 2013 BB&T announced a deal to acquire 22 Texas offices from Citigroup Inc. (C); it then announced a second purchase for 41 Texas branches in September. Within a week BB&T announced a $367 million deal for Bank of Kentucky Financial Corporation (BFKY). In November, it announced a $2.5 billion acquisition of Pennsylvania-based Susquehanna Bancshares (SUSQ). See Figure 1 for other details of these transactions.

The largest transaction announced year-to-date is CIT Group's (CIT) $3.4 billion deal for IMB HoldCo, a privately-held entity that formed OneWest Bank from the failed IndyMac Bank, as shown in Figure 1. The transaction may be an outlier because CIT was under pressure from the Federal Reserve to build a core deposit franchise that does not yet exist in subsidiary CIT Bank, which traces its roots to a Utah industrial loan charter.

We do not know whether Davis is right about large bank M&A activity being episodic rather than on the cusp of picking-up. What is apparent is that the operating environment for banks remains challenging with pressure on NIMs, increasing regulatory costs and limited opportunities to improve fee income. As a result, we see no reason deal activity will slow from the 3-4% of the industry being absorbed each year other than as a result of a sharp drop in markets and/or a downturn in credit. The return of BB&T and the addition of the likes of First Horizon National Corporation (FHN) should, at the margin, support activity and maybe pricing to the extent it supports investor and banker confidence in the sector.

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Recent Bank Speech

Issues, Trends and Developments in Banking Industry Valuations

With the banking industry facing new regulations and other pressures, this session focuses on the current environment at banks and valuation techniques appropriate for rendering valuation opinions that are consistent with this environment. Attendees will:

- » Understand the current environment facing depository institutions and its effect on their valuation
- » Appreciate unique factors affecting the valuation of depository institutions that are not present in the valuation of non-financial companies
- » Identify and execute valuation methodologies consistent with this environment

Download the slides at **http://mer.cr/1EVqRRf**.

What We're Reading

Elizabeth Dexheimer of *Bloomberg* wrote an article on today's changing market with mergers and acquisitions following the financial crisis.

http://mer.cr/1qOVfo3

Jeff Davis of Mercer Capital has interesting article taking a look at key takeaways from the Federal Reserve's 2014 Shared National Credit exam nuggets.

http://mer.cr/1sNzBAm

Al Dominick of *Bank Director* has a nice article discussing the importance of earnings in measuring a bank's value.

http://mer.cr/1vkNX1Z

Emily McCormick of Bank Director has the preliminary findings of Bank Director's 2015 Bank M&A Survey.

http://mer.cr/1Hah3oE

John Allison, CEO of the Cato Institute and former chairman and CEO of BB&T, has an interesting series on "Creating a Win-Win in M&A." Part 1 of the series talks about his logic for bank's to consider in using M&A as part of a growth strategy.

http://mer.cr/1qetkDs

Figure 1: Top 12 Bank Deals for 2014

Announce Date	Buyer	Seller	Seller Assets ($M)	Deal Value ($M)	Price/ TBV (%)	Price/ Net Inc. (x)
7/22/14	CIT Group Inc.	IMB HoldCo LLC	21,807	3,369	102	13.7
11/12/14	BB&T Corp.	Susquehanna Bancshares Inc.	18,583	2,501	172	16.6
11/5/14	Banner Corp.	Starbuck Bancshares Inc.	4,087	702	148	37.5
6/10/14	First Citizens Banc-Shares Inc.	First Citizens Bancorp.	8,532	676	118	14.2
11/5/14	Sterling Bancorp	Hudson Valley Holding Corp.	3,120	538	188	NM
9/8/14	BB&T Corp.	Bank of Kentucky Finl Corp.	1,858	367	218	17.4
10/29/14	WesBanco Inc.	ESB Financial Corp.	1,945	353	214	19.8
9/25/14	Ford Financial Fund II L.P.	Mechanics Bank	3,303	338	164	27.7
4/29/14	Southside Bancshares Inc.	OmniAmerican Bancorp Inc.	1,391	314	152	43.6
5/8/14	Valley National Bancorp	1st United Bancorp Inc.	1,738	313	187	36.1
1/27/14	Yadkin Financial Corporation	VantageSouth Bancshares	2,046	299	147	49.6
7/15/14	TowneBank	Franklin Financial Corp.	1,095	278	115	23.1

Source: SNL Financial Data, as of November 14, 2014

Figure 2: Top 12 Bank Deals for 2009-2013

Announce Date	Buyer	Seller	Seller Assets ($M)	Deal Value ($M)	Price/ TBV (%)	Price/ Net Inc. (x)
6/16/11	Capital One Financial Corp.	ING Bank FSB	92,222	9,000	102	31.9
12/17/10	Bank of Montreal	Marshall & Ilsley Corp.	51,887	4,096	98	NM
8/27/12	M&T Bank Corp.	Hudson City Bancorp Inc.	43,590	3,813	85	NM
6/20/11	PNC Financial Services Group	RBC Bank (USA)	27,376	3,450	97	NM
7/22/13	PacWest Bancorp	CapitalSource Inc.	8,483	2,382	177	5.4
9/11/13	Umpqua Holdings Corp.	Sterling Financial Corp.	9,940	1,995	173	19.1
3/12/12	Mitsubishi UFJ Finl Grp Inc	Pacific Capital Bancorp	5,850	1,516	225	21.5
8/19/10	First Niagara Finl Group	NewAlliance Bancshares Inc.	8,712	1,498	165	24.6
12/22/10	Hancock Holding Co.	Whitney Holding Corp.	11,517	1,468	164	NM
1/18/11	Comerica Inc.	Sterling Bancshares Inc.	5,040	1,029	232	NM
9/13/12	FirstMerit Corp.	Citizens Republic Bancorp Inc.	9,670	943	130	2.6
5/24/13	Banco de Credito e Inversiones	CM Florida Holdings Inc.	4,609	881	191	14.5

Source: SNL Financial Data, as of November 14, 2014

Mercer Capital's Resources for Depository Institutions

The Financial Institutions Group of Mercer Capital works with hundreds of depository institutions and other financial institutions annually providing a broad range of specialized resources for the financial services industry.

Newest Webinar

Sponsored by SNL Financial

An Introduction to Business Development Companies

In the hunt for yield, investors are increasingly setting their sights on business development companies (BDCs), which offer stock market investors access to portfolios of private equity investments. This webinar explored the features that have contributed to the growth in BDCs, underlying asset classes to which BDCs offer investors exposure, and highlighted the key performance metrics for evaluating BDCs. Our panel discussed relevant regulatory developments affecting BDCs, reviewed the portfolio valuation procedures and assumptions that influence quarterly profits, and explored the relative performance of key market benchmarks.

View webinar on SNL Financial's site at http://mer.cr/ZnauO7
Complimentary Download of Slides at http://mer.cr/1tuwzal

Webinars Available for Replay

An Overview of the Leveraged Lending Market and Bank Participation in the Market

There has been a flurry of media reports this year that regulators—especially the OCC—are intensifying scrutiny of leveraged lending. In this webinar we took a look at one of the fastest growing markets that has emerged post crisis.

View webinar on SNL Financial's site at http://mer.cr/VRc9JV

Understanding Deal Considerations

Key issues that we see when banks combine as it relates to valuing and evaluating a combination are reviewed. This is particularly critical when the consideration consists of shares issued by a buyer (or senior merger partner) whose shares are either privately held or are thinly traded.

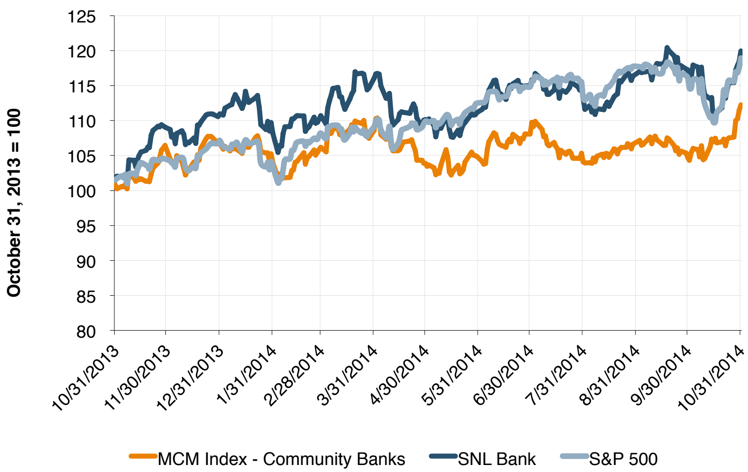
View replay at http://mer.cr/bnkweb2

Basel III Capital Rules Finally Final: What Does It Mean for Community Banks?

Finalized at last, the regulations provide direction for bank capital management decisions. This webinar, co-sponsored by Mercer Capital and Jones Day, reviews the final rules and assesses their impact on community banks.

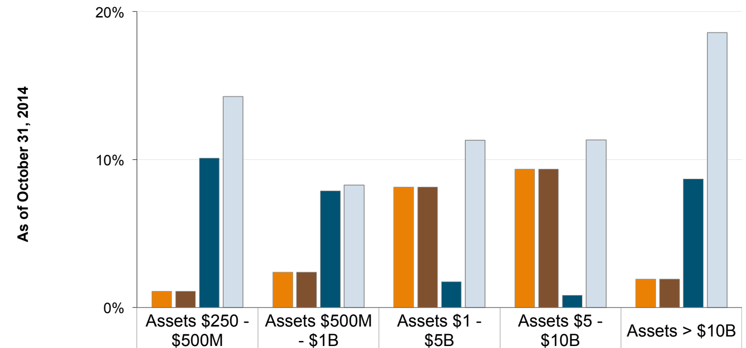
View replay at http://mer.cr/capital-rules-webinar

Mercer Capital's Bank Group Index Overview



Return Stratification of U.S. Banks

by Asset Size



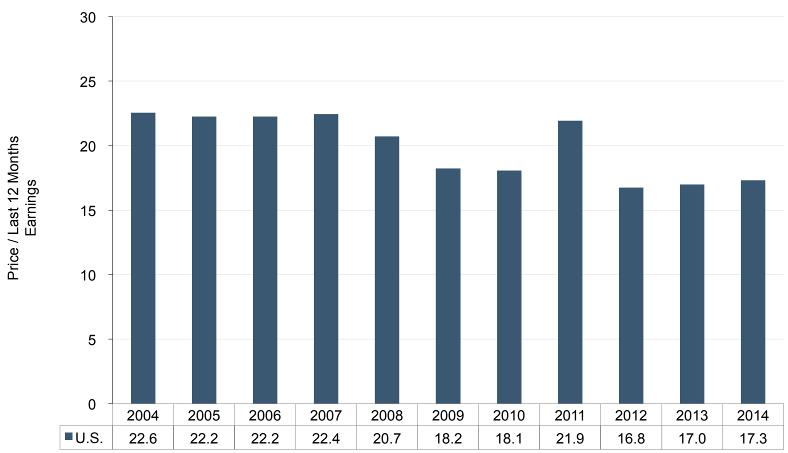
	Assets $250 - $500M	Assets $500M - $1B	Assets $1 - $5B	Assets $5 - $10B	Assets > $10B
Month-to-Date	1.09%	2.39%	8.13%	9.34%	1.91%
Quarter-to-Date	1.09%	2.39%	8.13%	9.34%	1.91%
Year-to-Date	10.09%	7.88%	1.75%	0.82%	8.69%
Last 12 Months	14.25%	8.27%	11.31%	11.33%	18.57%

Median Valuation Multiples

	Median Total Return				Median Valuation Multiples as of October 31, 2014					
Indices	Month-to-Date	Quarter-to-Date	Year-to-Date	Last 12 Months	Price/ LTM EPS	Price / 2014 (E) EPS	Price / 2015 (E) EPS	Price / Book Value	Price / Tangible Book Value	Dividend Yield
Atlantic Coast Index	8.53%	8.53%	7.45%	13.41%	16.55	19.68	14.68	108.8%	119.4%	2.2%
Midwest Index	4.12%	4.12%	5.55%	13.49%	14.14	13.93	13.23	113.3%	131.1%	2.0%
Northeast Index	7.94%	7.94%	3.86%	8.21%	14.63	14.97	13.12	122.2%	137.5%	2.7%
Southeast Index	4.91%	4.91%	6.64%	14.53%	12.33	14.16	13.87	115.0%	117.0%	1.6%
West Index	8.37%	8.37%	8.28%	13.17%	16.52	18.52	14.50	125.8%	141.5%	1.9%
Community Bank Index	7.25%	7.25%	5.19%	11.28%	14.94	15.70	13.83	118.2%	129.6%	2.1%
SNL Bank Index	**2.33%**	**2.33%**	**8.13%**	**17.98%**						

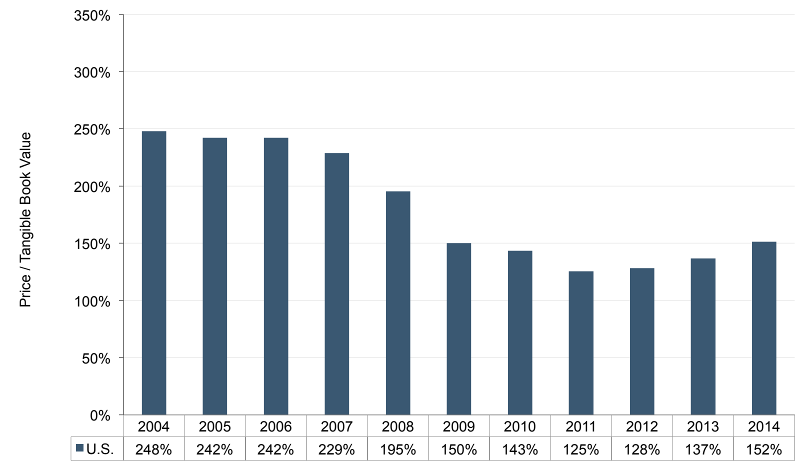
Median Price/Earnings Multiples

Target Banks Assets <$5B and LTM ROE >5%



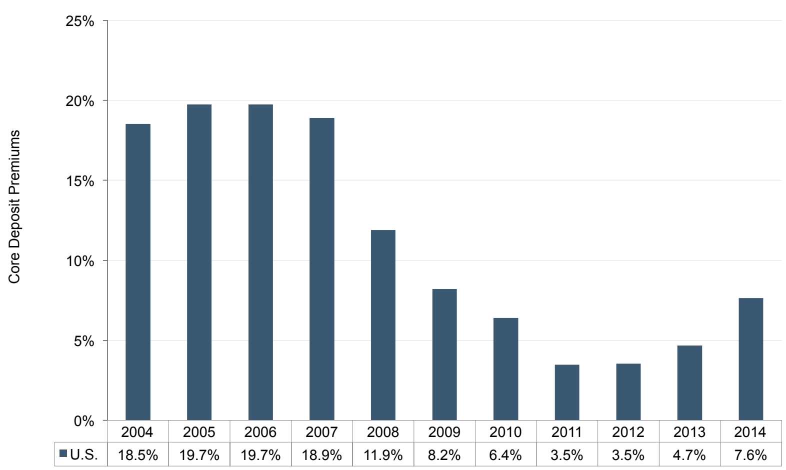
Median Price/Tangible Book Value Multiples

Target Banks Assets <$5B and LTM ROE >5%



Median Core Deposit Multiples

Target Banks Assets <$5B and LTM ROE >5%



Median Valuation Multiples for M&A Deals

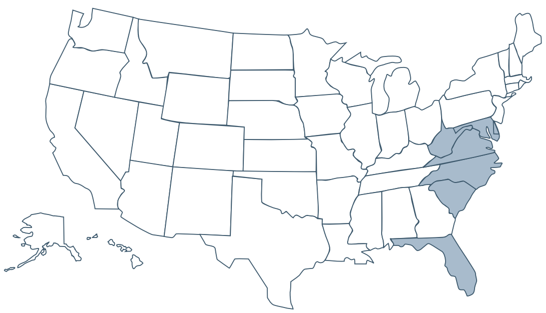
Target Banks Assets <$5B and LTM ROE >5%, through October 2014

Regions	Price / LTM Earnings	Price / Tang. BV	Price / Core Dep Premium	No. of Deals	Median Deal Value	Target's Median Assets	Target's Median LTM ROAE (%)
Atlantic Coast	19.92	1.60	10.2%	9	56.40	312,005	8.78%
Midwest	18.03	1.49	6.7%	51	47.20	117,155	8.90%
Northeast	17.33	1.87	11.2%	8	106.07	615,348	8.66%
Southeast	14.83	1.61	8.4%	26	74.37	232,106	9.91%
West	20.21	1.42	6.6%	15	58.98	407,960	8.03%
Nat'l Community Banks	**17.31**	**1.52**	**7.6%**	**109**	**56.70**	**225,187**	**8.94%**

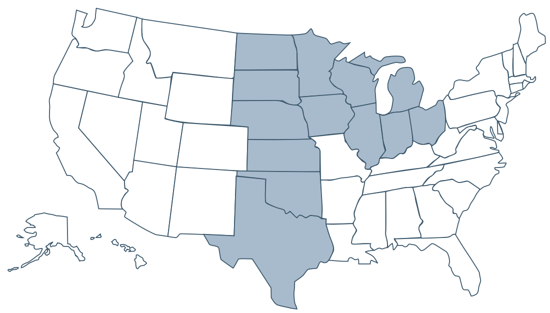
Source: Per SNL Financial

Mercer Capital's Regional Public Bank Peer Reports

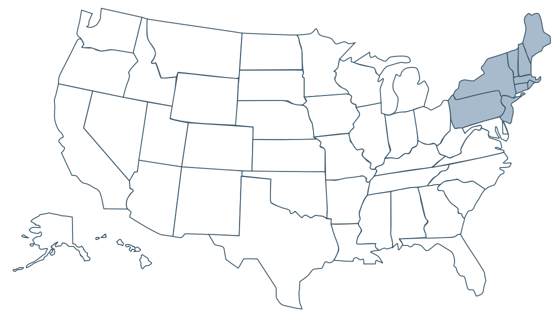
Updated weekly, Mercer Capital's Regional Public Bank Peer Reports offer a closer look at the market pricing and performance of publicly traded banks in the states of five U.S. regions. Click on the map to view the reports from the representative region.



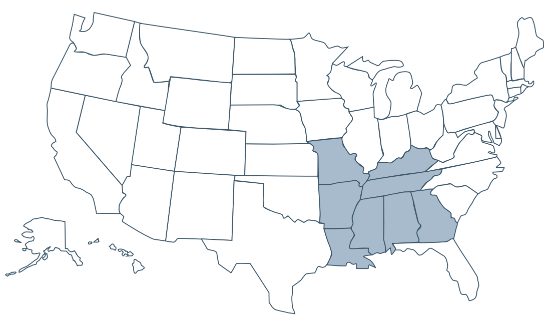
Atlantic Coast



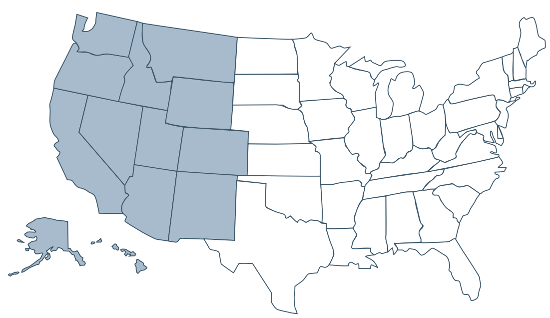
Midwest



Northeast



Southeast



West

Mercer Capital

Financial Institutions Services

Mercer Capital assists banks, thrifts, and credit unions with significant corporate valuation requirements, transactional advisory services, and other strategic decisions.

Mercer Capital pairs analytical rigor with industry knowledge to deliver unique insight into issues facing banks. These insights underpin the valuation analyses that are at the heart of Mercer Capital's services to depository institutions.

Mercer Capital is a thought-leader among valuation firms in the banking industry. In addition to scores of articles and books, *The ESOP Handbook for Banks* (2011), *Acquiring a Failed Bank* (2010), *The Bank Director's Valuation Handbook* (2009), and *Valuing Financial Institutions* (1992), Mercer Capital professionals speak at industry and educational conferences.

The Financial Institutions Group of Mercer Capital publishes *Bank Watch*, a monthly e-mail newsletter covering five U.S. regions. In addition, Jeff Davis, Managing Director, is a regular contributor to SNL Financial.

For more information about Mercer Capital, visit www.mercercapital.com.

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