

Bank Watch



January 2018

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It's Tax Time

Implications of Tax Reform for Banks

A Memphis establishment long has used the slogan, "It's Tax Time (... Baby)," in their low budget television advertising. After listening to early fourth quarter earnings calls, banks – and especially their investors – appear to be embracing this slogan as well. Four investment theses undergirded the revaluation of bank stocks after the 2016 presidential election: regulatory reform, higher interest rates, faster economic growth, and tax reform. One year later, regulatory reform is stymied in Congress, and legislative efforts appear likely to yield limited benefits. Short-term rates have risen, but the benefit for many banks has been squashed by a flatter yield curve and competition for deposits. Economic growth has not yet translated into rising loan demand.

Fortunately for bank stock valuations, the tax reform plank materialized in the Tax Cuts and Jobs Act of 2017 (the "Act").¹ The Act has sweeping implications for banks, influencing more than their effective tax rates. This article explores these lesser known ramifications of the Act.²

¹ Lest we be accused of imprecision, the Act's formal name is "An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018."

² Before proceeding, we include the de rigueur disclaimer for articles describing the Act that Mercer Capital does not provide tax advice and banks should consult with appropriate tax experts.

Table 1

	C Corporation			
		Old Regime	New Regime	Change
Corporate Level				
Pre-Tax Income		\$10,000,000	\$10,000,000	0%
- Taxes	35%	(3,500,000)	21% (2,100,000)	-40%
After-Tax Income		\$6,500,000	\$7,900,000	22%
Return on Equity		12.50%	15.19%	22%
Shareholder Level				
Dividends Paid		\$6,500,000	\$7,900,000	
Income Tax	20.0%	1,300,000	20.0% 1,580,000	
+ Net Investment Income Tax	3.8%	247,000	3.8% 300,200	
= Total Individual Taxes		\$1,547,000	\$1,880,200	
Shareholder Cash Flow		\$6,500,000	\$7,900,000	
- Taxes Paid		(1,547,000)	(1,880,200)	
= After-Tax Shareholder Cash Flow		\$4,953,000	\$6,019,800	
Effective Total Tax Rate (Corporate + Personal)		50.5%	39.8%	

C Corporations & The Act

In 2017, the total effective tax rate on C corporation earnings – at the corporate level and, assuming a 100% dividend payout ratio, at the shareholder level – was 50.5%. Under the Act, this rate will decline to 39.8%, reflecting the new 21% corporate rate and no change in individual taxes on dividends. For a hypothetical bank currently facing the highest corporate tax rate, the Act will cause a 40% reduction in tax expense, a 22% increase in after-tax earnings, and a 269bp enhancement to return on equity (Table 1 on page 1).

Table 2

2017 Effective Rate	Taxes at 2017 Rates	Taxes at 2018 Rates	Tax Savings	2018 Effective Rate
35%	\$3,500,000	\$2,100,000	\$1,400,000	21%
30%	\$3,000,000	\$1,800,000	\$1,200,000	18%
25%	\$2,500,000	\$1,500,000	\$1,000,000	15%
20%	\$2,000,000	\$1,200,000	\$800,000	12%

Table 3

	Effective Tax Rate (2016)	Stock Price Change (2017)	Range of Tax Rates
Top Quartile	35.9%	10.3%	34.1% - 39.4%
3rd Quartile	32.8%	4.1%	31.3% - 34.1%
2nd Quartile	29.5%	0.8%	27.1% - 31.3%
Lowest Quartile	24.3%	1.2%	11.3% - 26.9%

Source: S&P Global Market Intelligence, Mercer Capital research
Values in the table are medians of each quartile

The benefit reduces, however, for banks with lower effective tax rates resulting from, among other items, tax-exempt interest income. Continuing the example in Table 1, which assumed a 35% effective tax rate, Table 2 illustrates the effect on banks with 30%, 25%, and 20% effective tax rates.

Since investors in bank stocks value after-tax earnings, not surprisingly banks with the highest effective 2016 tax rates experienced the greatest share price appreciation in 2017. Table 3 analyzes share price changes for publicly-traded banks with assets between \$1 and \$10 billion.

Implications

The preceding tax examples distill a nuanced subject into one number, namely an effective tax rate. The implications of the Act for banks, though, spread far beyond mathematical tax calculations. We classify the broader implications of the Act into the following categories:

1. "Allocation" of Tax Savings
2. Lending
3. Miscellaneous

Implication #1: "Allocation" of Tax Savings

We know for certain that the tax savings resulting from the Act will be allocated among three stakeholder groups – customers, employees, and shareholders.³ The allocation between these groups remains unknown, though.

³ We recognize that some of the tax savings may be invested in capital expenditures or community relations, but these expenditures ultimately are intended to benefit one of the three stakeholder groups identified previously.

Customers

Jamie Dimon had a succinct explication of the effect of the Act on customers:

And just on the tax side, so these people understand, generally, yes, if you reduce the tax rates, all things being equal, to 20% or something, eventually, that increased return will be competed away.⁴

The logic is straightforward. The after-tax return on lending and deposit-taking now has increased; higher after-tax returns attract competition; the new competitors then eliminate the higher after-tax returns. Rinse and repeat. One assumption underlying Mr. Dimon's statement, though, is that prospective after-tax returns will exceed banks' theoretical cost of capital. If not, loan and deposit pricing may not budge, relative to the former tax rate regime. Supporting the expectation that customers will benefit from the Act is the level of capital in the banking industry searching for lending opportunities.

Renasant Corporation has noted already potential pressure on its net interest margin.

Not sure [net interest margin expansion is] going to hold. We'll need a quarter or 2 to see what competitive reaction is to say that we'll have margin expansion. But we do think that margin at a minimum will be flat and would be variable upon competitive pressures around what's down with the tax increase.⁵

Employees

An early winner of tax reform was employees of numerous banks, who received one-time bonuses, higher compensation, and upgraded benefits packages. With falling unemployment rates, economists will debate whether employers would have made

⁴ Transcript of J.P. Morgan Chase & Co.'s Fourth Quarter 2016 earnings call.

⁵ Transcript of Renasant Corporation's Fourth Quarter 2017 earnings call.

such compensation adjustments absent the Act. Nevertheless, the public nature of these announcements, with local newspapers often covering such promises, will create pressure on other banks to follow suit.

Generally, bank compensation adjustments have emphasized entry level positions. An open question is whether such benefits will spread to more highly compensated positions, thereby placing more pressure on bank earnings. For example, consider a relationship manager who in 2017 netted the bank \$100 thousand after considering the employee's compensation and the cost of funding, servicing, and provisioning her portfolio. Assuming that customers do not capture the benefit, the officer's portfolio suddenly generates after-tax net income of \$122 thousand. The loan officer could well expect to capture a share of this benefit, or take her services to a competitor more amenable to splitting the benefit of tax reform.

Shareholders

Mr. Market clearly views shareholders as the biggest winner of tax reform, and we have no reason to doubt this – at least in the short-run. Worth watching is the form this capital return to shareholders takes. With bank stocks trading at healthy P/Es, even adjusted for tax reform, banks may hesitate to be significant buyers of their own stock. Instead, some public banks have suggested higher dividends are in the offing. Meanwhile, Signature Bank (New York), which has not paid dividends historically, indicated it may initiate a dividend in 2018. In the two days after the CEO's announcement, Signature's stock price climbed 8%.

Table 4 on pages 4-7 compiles announced expenditures by certain banks on employees, philanthropy, and capital investments.

Some public market analysts have "allocated" 60% to 80% of the tax savings to shareholders, with the remainder flowing to other stakeholders. Time will tell, but banks will face pressure from numerous constituencies to share the benefits.

Table 4

Name of Bank	State / Total Assets (\$millions)	Higher Wages	Employee Bonuses	Charitable Contributions	Capital Expenditures / Technological Upgrades	Other
American Savings Bank	HI \$6,619	\$15.25 Minimum Wage	\$1,000 All Non-Executive Employees; Affects 1,150 Employees			
Aquesta Financial Holdings, Inc.	NC \$377	\$15 Minimum Wage	\$1,000 All Employees			
Associated Banc-Corp.	WI \$30,065	\$15 Minimum Wage	\$500 All Hourly, Non-Commissioned Employees (Affecting 55% of Employees)	\$3.5 Million Charitable Grants	Enhance Online & Mobile Banking Platforms	
Bank of America Corp.	NC \$2,285,062		\$1,000 All U.S. Employees Earning Less Than \$150,000 (145,000 Employees)		Accelerate Expansion in Newer Markets, Refresh Branches, and Greater Technology Spend	
Bank of the James Financial Group, Inc.	VA \$620	\$15 Minimum Wage		Increased the Charitable Giving Budget for 2018		
Bank of Hawaii Corp.	HI \$17,268	\$15 Minimum Wage Affects 565 Employees	\$1,000 All Employees Below Senior Vice President Level; Affects 2,074 Employees (95% of the Workforce)			
BB&T Corp.	NC \$220,340	\$15 Minimum Wage	\$1,200 Paid to 27,000 Employees (75% of the Workforce)	\$100 Million to BB&T's Philanthropic Fund		
Central Bancompany, Inc.	MO \$12,601		\$1,000			
Central Pacific Financial Corporation	HI \$5,569	\$15.25 Minimum Wage Affects 126 Employees; Increased Pay for Non-Entry Level Positions to Maintain Wage Progression Scale	\$1,000 All Non-Executive Employees			
Citizens Financial Group, Inc.	RI \$151,764		\$1,000 Paid to Approximately 12,500 Employees, Representing Over 70% of the Workforce	\$10 Million to Citizens Charitable Foundation		

Name of Bank	State / Total Assets (\$millions)	Higher Wages	Employee Bonuses	Charitable Contributions	Capital Expenditures / Technological Upgrades	Other
Comerica Inc.	TX \$72,269	\$15 Minimum Wage	\$1,000 Paid to 4,500 Non-Officer Employees (> 50% of Workforce)			
Commerce Bancshares, Inc.	MO \$25,004		\$1,000 All Non-Commission & Non-Bonus Eligible Employees; Affects 3,450 Employees (75% of the Workforce)	\$25 Million to The Commerce Bancshares Foundation		
Community Trust Bancorp, Inc.	KY \$4,136		\$1,000 All Employees Except Executive Management			
Customers Bank	PA \$10,472			\$1 Million Increase in Charitable Giving		Higher Deposit Rates
Fidelity D&D Bancorp, Inc.	PA \$880		\$1,000 Paid to Employees Earning Less than \$100,000	\$500,000 to New Charitable Foundation		
Fifth Third Bancorp	OH \$142,264	\$15 Minimum Wage Affects Approximately 3,000 Employees	\$1,000 Paid to Approximately 13,500 Employees			
First Capital Bank of Texas	TX \$1,119		\$500 Paid to 197 Employees			
First Financial Northwest, Inc.	WA \$1,164		\$1,000 (after tax) Paid to 138 Non-Executive Employees			
First Hawaiian, Inc.	HI \$20,546	\$15 Minimum Wage Affects 613 Employees	\$1,500 Paid to 2,264 Employees (All But 11 Senior Managers)			
First Horizon National Corporation	TN \$29,624		\$1,000 Paid to Employees Who Do Not Participate in Company-Sponsored Bonus Plans			
Gate City Bank	ND \$2,072		\$1,000 (net of tax) Paid to All Non-Managerial Employees	\$500,000 Increase in Charitable Donations		\$500,000 of Free Home Appraisals

Name of Bank	State / Total Assets (\$millions)	Higher Wages	Employee Bonuses	Charitable Contributions	Capital Expenditures / Technological Upgrades	Other
HarborOne Bancorp, Inc.	MA \$2,662	\$15 Minimum Wage	\$500 to 600 Employees			
Inland Northwest Bank	WA \$827	\$15 Minimum Wage Increased Pay for Non-Entry Level Positions to Maintain Wage Progression Scale (Affecting >33% of Workforce)	\$500 to All Employees, Except Senior Management (200 Employees)			
Meridian Bancorp, Inc.	MA \$5,087	\$15 Minimum Wage	Additional 20% Added to 2017 Bonus Pool (Paid to 500+ Employees)	\$1 Million Increase in Charitable Donations	Increase to the Capital Spending Budget Related to New Branches	
Ohnward Bancshares, Inc.	IA \$1,126		\$1,000 Paid to All Employees			
PNC Financial Services Group, Inc.	PA \$375,256	\$15 Minimum Wage	\$1,000 Paid to 47,500 Employees, or 90% of Employees	\$200 Million to PNC Foundation		\$1,500 Contribution to Each Participant in the Defined Benefit Plan
Regions Financial Corp.	AL \$123,518	\$15 Minimum Wage Affects 25% of Employees		\$40 Million to Regions Foundation	\$100 Million 50% Increase in Budget over 2017 for Facilities and Technology	
Summit State Bank	CA \$539		\$2,000 All Non-Executive Employees			
SunTrust Banks, Inc.	GA \$208,366	\$15 Minimum Wage Merit Base Pay Increases for Other Hourly Employees (20% of Workforce)		\$50 Million Additional Grants to Financial Well-Being Efforts		1% 401(k) Contribution; \$1,000 Incentive for Employees Participating in Financial Wellbeing Program
TCF Financial Corp.	MN \$23,019		\$1,000 Paid to Employees Earning Less than \$100,000 (80% of the Workforce)	\$5 Million to TCF Foundation; Match Employee Charitable Contributions 200% (up from 100%)		

Name of Bank	State / Total Assets (\$millions)	Higher Wages	Employee Bonuses	Charitable Contributions	Capital Expenditures / Technological Upgrades	Other
US Bancorp	MN \$459,227	\$15 Minimum Wage	\$1,000 Paid to Approximately 60,000 Employees	\$150 Million to U.S. Bank Foundation	Additional Investment Emphasizing Digital and Mobile Technology	Enhancements to Medical Benefits
Washington Federal, Inc.	WA \$15,254	5% Employees Earning Less than \$100,000 Will Receive a 5% Increase in Pay		\$5 Million to Washington Federal Foundation	Investments in Technology Infrastructure, Including Online Platforms and 2nd Tech Hub; 25% Increase in Tech Staff	Additional Spending on Employee Training and Development
Wells Fargo & Co.	CA \$1,934,939	\$15 Minimum Wage		\$400 Million Target for 2018 to Community and Nonprofit Organizations; Up 40% from 2017; Target 2% of After-Tax Income		\$100 Million Directed to Diverse Small Businesses and \$75 Million to Homeownership
Windsor Federal Savings	CT \$466	\$15 Minimum Wage	\$250 All Employees, Except Senior Management			
Zions Bancorporation	UT \$65,564	Increase Ongoing Compensation for 40% of Employees	\$1,000 Paid to Approximately 80% of Employees	\$12 Million to Zions Bancorporation Foundation		

Source: Company disclosures, American Bankers Association, American Banker, Mercer Capital research

Implication #2: Lending

The Act potentially affects loan volume with future possible effects on credit quality.

Volume

Looked at most favorably, higher economic growth resulting from the Act, as well as accelerated capital expenditures due to the Act's depreciation provisions, may provide a tailwind to loan growth. However, some headwinds exist too. Businesses may use their tax savings to pay down debt or fund investments with internal resources. The Act eliminates the deductibility of interest on home equity loans and lines of credit, potentially impairing their attractiveness to consumers. Last, the Act disqualifies non-real estate assets from obtaining favorable like-kind exchange treatment, potentially affecting some types of equipment finance.

What We're Reading

Pymnts ran an interesting article entitled "[The Role of SMB Lending At Community Banks is Changing](#)."

Jack Milligan at *Bank Director* discusses 2017 bank M&A in "[Acquirers Cautious and Disciplined in 2017](#)."

Kevin Dobbs at S&P Global Market Intelligence also addresses bank M&A in his article "[Southeast, Texas Remain M&A Hot Spots](#)."

Quality

While we do not expect the Act to cause any immediate negative effects on credit quality, certain provisions "reallocate" a business' cash flow between the Treasury and other stakeholders (e.g., creditors) in certain circumstances:

- 1. Net Operating Loss ("NOL") Limitations.** Tax policy existing prior to the Act allowed businesses to carry back net operating losses two years, which provided an element of countercyclicality in periods of economic stress. The Act eliminates the carryback provision. Further, businesses can apply only 80% of future NOLs to reduce future taxable earnings, down from 100% in 2017, thereby potentially pressuring a business' cash flow as it recovers from losses. As a result, less cash flow may be available to service debt.
- 2. Interest Deductibility Limitations.** The Act caps the interest a business may deduct to 30% of EBITDA (through 2021) and EBIT (thereafter) for entities with revenue exceeding \$25 million.⁶ Assuming a 5% interest rate, a business' debt must exceed 6x EBITDA before triggering this provision. Several issues arise from this new limitation. First, community banks may have clients that manage their expenses to achieve a specified tax result, which could face disallowed interest payments. Second, in a stressed economic scenario, cash flow may be diverted to cover taxes on nondeductible interest payments, rather than to service bank debt.
- 3. Real Estate Entities.** The Act appears to provide relatively favorable treatment of real estate managers and investors. However, banks should be aware that the intersection of (a) the interest deductibility limitations and (b) the Act's depreciation provisions may affect borrower cash flow. Entities engaged in

⁶ Floor plan financing is exempt from this provision.

a “real property trade or business” may opt out of the 30% interest deductibility limitation. However, such entities (a) must depreciate their assets over a longer period and (b) cannot claim 100% bonus depreciation for improvements to the interior of a commercial property.

Banks should also prepare for reorganizations among business borrowers currently taxed as pass-through entities, especially in certain service businesses not qualifying for the 20% deduction described subsequently. From a tax planning standpoint, it may be advisable for some business clients to reorganize with certain activities conducted under a C corporation and others under a pass-through structure.

Implication #3: Miscellaneous Considerations

Additional considerations include:

Effect on Tangible Book Value

Table 5 presents, for publicly traded banks with assets between \$1 billion and \$5 billion, their net deferred tax asset or liability positions as a percentage of tangible common equity. Table 5 also presents the number of banks reporting net DTAs or DTLs.

From a valuation standpoint, we do not expect DTA write-downs to cause significant consternation among investors. If Citigroup's \$22 billion DTA revaluation did not scare investors, we doubt other banks will experience a significant negative reaction. In Citigroup's case, the impairment has the salutary effect of boosting its future ROE, as Citigroup's regulatory capital excluded a large portion of the DTAs anyway.

Regulatory Capital⁷

The Basel III capital regulations limit the inclusion of DTAs related to temporary differences in regulatory capital, but DTAs that could be realized through using NOL

Table 5

DTA or DTL as a % of TCE		Count		Median DTA (DTL) / TCE	
1st Quartile	2.3%	Net DTA Position	132	93%	4.5%
Median	4.2%	Net DTL Position	10	7%	-2.0%
3rd Quartile	7.0%				

Source: S&P Global Market Intelligence, Mercer Capital research

carrybacks are not subject to exclusion from regulatory capital. As noted previously, though, the Act eliminates NOL carrybacks. Therefore, certain banks may face disallowances (or greater disallowances) of portions of their DTAs when computing common equity Tier 1 regulatory capital.⁸

Business Investments

An emerging issue facing community banks is their relevance among technology savvy consumers and businesses. Via its “bonus” depreciation provisions, the Act provides tax-advantaged options for banks to address technological weaknesses. For qualifying assets – generally, assets other than real estate and, under the Act, even used assets – are eligible for 100% bonus depreciation through 2022. The bonus depreciation phases out to 0% for assets placed in service after 2026.⁹

⁷ See also Federal Reserve, Supervisory & Regulatory Letter 18-2, January 18, 2018.

⁸ Generally, DTAs are includible in regulatory capital up to a fixed percentage of common equity Tier 1 capital.

⁹ In addition, §179 allows entities to expense the cost of certain assets. The §179 limit increases from \$500 thousand in 2017 to \$1 million in 2018. The Act also expands the definition of assets subject to §179 to include all leasehold improvements and certain building improvements.

Mergers & Acquisitions

Our understanding is that the Act will not materially change the existing motivations for structuring a transaction as non-taxable or taxable. With banks accumulating capital at a faster pace given a reduced tax rate, it will be interesting to observe whether cash increases as a proportion of the overall consideration mix offered to sellers.

Permanence of Tax Reform

One parting thought concerns the longevity of the recent tax reforms. The Act passed via reconciliation with no bipartisan support, unlike the Tax Reform Act of 1986. As exhibited recently by the CFPB, the regulatory winds can shift suddenly. Like the CFPB, is tax reform built on a foundation of sand?

S Corporations & The Act

At the risk of exhausting our readership, we will detour briefly through the Act's provisions affecting S corporations (§199A). While the Act's authors purportedly intended to simplify the Code, the smattering of "lesser of the greater of" tests throughout §199A suggests that this goal went unfulfilled.

Briefly, the Act provides that shareholders of S corporations can deduct 20% of their pro rata share of the entity's Qualified Business Income ("QBI"), assuming that the entity is a Qualified Trade or Business ("QTB") but not a Specified Service Trade or

Table 6

	S Corporation			
	Old Regime		New Regime	
Corporate Level				
Pre-Tax Income		\$10,000,000		\$10,000,000
- Taxes	0%	0	0%	0
After-Tax Income		\$10,000,000		\$10,000,000
Shareholder Level				
Shareholder Income		\$10,000,000		\$10,000,000
- Qualified Business Income Deduction	0.0%	0	20.0%	(2,000,000)
= Adjusted Shareholder Income		\$10,000,000		\$8,000,000
Income Tax	39.6%	3,960,000	37.0%	2,960,000
+ Net Investment Income Tax	3.8%	380,000	3.8%	380,000
+ Phase-Out of Itemized Deductions ⁽¹⁾	1.2%	120,000	0.0%	0
= Total Individual Taxes		\$4,460,000		\$3,340,000
Shareholder Cash Flow		\$10,000,000		\$10,000,000
- Taxes Paid		(4,460,000)		(3,340,000)
= After-Tax Shareholder Cash Flow		\$5,540,000		\$6,660,000
Effective Total Tax Rate (Corporate + Personal)				
		44.6%		33.4%
Memo: C Corporation Total Tax Rate				
		50.5%		39.8%

⁽¹⁾ For certain high income taxpayers, itemized deductions phase-out under tax code provisions referred to as the Pease limitations. The Act repeals the Pease limitations.

Business ("SSTB").¹⁰ That is, shareholders of QTBs that are not SSTBs can deduct 20% of their pro rata share of the entity's QBI.¹¹ Simple.

The 20% QBI deduction causes an S corporation's prospective tax rate to fall to 33.4%, versus the 44.6% total rate applicable in 2017, thereby remaining below the comparable total C corporation tax rate (Table 6).

S corporations should review closely the impact of the Act on their tax structure. The 2013 increase in the top marginal personal rate to 39.6% and the imposition of the Net Investment Income Tax on passive shareholders previously diminished the benefit of S corporation status. The Act implements a \$10 thousand limit on the deductibility of state and local taxes, which may further diminish the remaining

¹⁰ We recognize that the risk of exploding heads is acute with reference to §199A. Therefore, we avoided discussion of the limits on the 20% deduction relating to W-2 and other compensation, "qualified" property, and overall taxable income, as well as the various income thresholds that exist. Suffice to say, §199A is considerably more complex than we have described.

¹¹ It does not appear that banks are SSTBs (and, thus, banks are eligible for the 20% deduction), although the explanation is mind numbing. An SSTB is defined in §199A by reference to §1202(e)(3)(A) but not §1202(e)(3)(B). Existing §1202 provides an exclusion from gain on sale to holders of "qualified small business stock." However, §1202(e)(3)(A) and §1202(e)(3)(B) disqualify certain businesses from using the QSB stock exclusion. Banks are specifically disqualified from the QSB stock sale exclusion under §1202(e)(3)(B). Since §199A's definition of an SSTB does not specifically cite the businesses listed in §1202(e)(3)(B), such as banks, §199A has been interpreted to provide that banks are not SSTBs. Interested in more SSTB arcana? Architects and engineers are excluded specifically from the list of businesses ineligible for the 20% deduction, apparently speaking to the lobbying prowess of their trade groups (or their ability to build tangible things).

¹² We are not aware that the Act limits the increase in an S corporation shareholder's tax basis arising from earnings not distributed to shareholders. However, the tax basis advantage of S corporation status typically is secondary to the immediate effect of an S corporation election on a shareholder's current tax liability.

¹³ To be fair, we should limit the "math exercise" comment to C corporations; the S corporation provisions in §199A undeniably are abstruse.

benefit of S corporation status. While we understand this limitation will not affect the deductibility of taxes paid by the S corporation itself (such as real estate taxes on its properties), it may reduce shareholders' ability to deduct state-level taxes paid by a shareholder on his or her pro rata share of the S corporation's earnings. S corporations also should evaluate their projected shareholder distributions, as S corporations distributing only sufficient amounts to cover shareholders' tax liability may see fewer benefits from maintaining an S corporation election.¹²

Conclusion

For banks, the provisions of the Act intertwine throughout their activities. Calculating the effect of a lower tax rate on a bank's corporate tax liability represents a math exercise; predicting its effect on other constituencies is fraught with uncertainty.¹³ We look forward to discussing with clients how the far reaching provisions of the Act will affect their banks, clients, and the economy at large. It will be Tax Time for quite some time. As always, Mercer Capital is available to discuss the valuation implications of the Act.

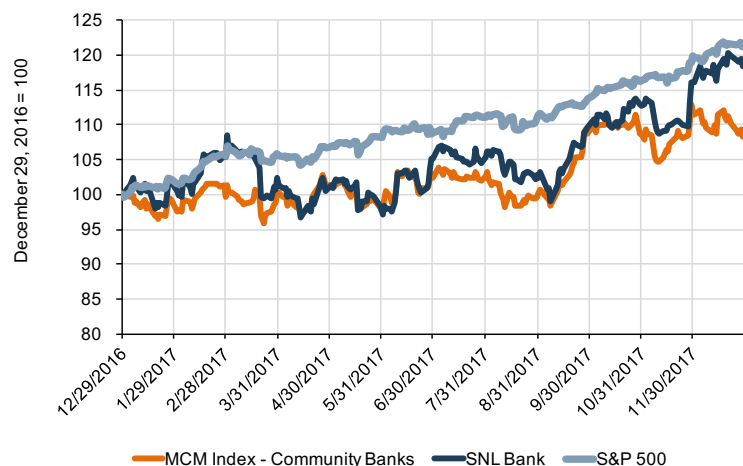
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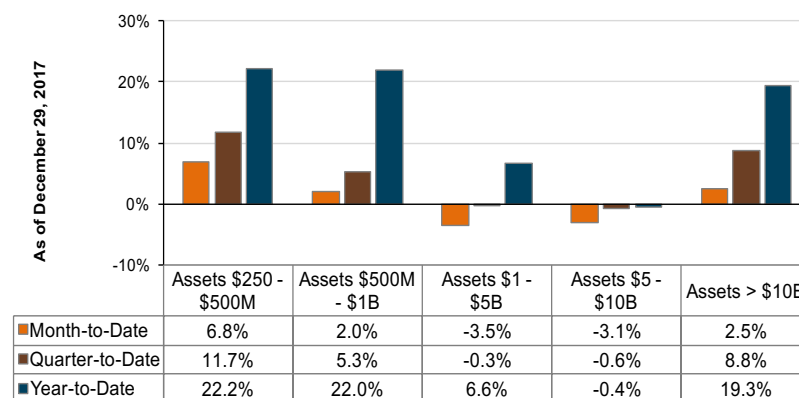
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Mercer Capital's Bank Group Index Overview



Return Stratification of U.S. Banks

by Asset Size



Median Valuation Multiples

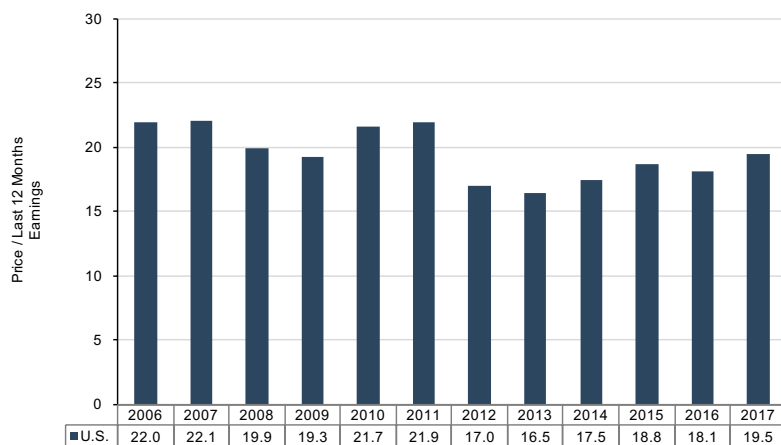
Median Total Return as of December 29, 2017

Median Valuation Multiples as of December 29, 2017

Indices	Median Total Return as of December 29, 2017			Median Valuation Multiples as of December 29, 2017					
	Month-to-Date	Quarter-to-Date	Year-to-Date	Price/LTM EPS	Price / 17(E) EPS	Price / 18(E) EPS	Price / Book Value	Price / Tangible Book Value	Dividend Yield
Atlantic Coast Index	-3.4%	0.7%	14.0%	21.8x	19.3x	15.2x	149%	163%	1.7%
Midwest Index	-2.4%	0.0%	7.1%	17.6x	17.5x	14.1x	149%	174%	2.1%
Northeast Index	-4.0%	-2.6%	6.4%	17.2x	17.7x	14.8x	148%	167%	2.2%
Southeast Index	-0.4%	0.5%	4.3%	17.6x	20.6x	16.7x	140%	149%	1.2%
West Index	-3.0%	0.1%	10.5%	17.4x	18.6x	14.9x	141%	148%	1.7%
Community Bank Index	-2.8%	-0.4%	8.4%	18.3x	18.3x	15.0x	148%	163%	1.8%
SNL Bank Index	2.1%	8.1%	18.5%						

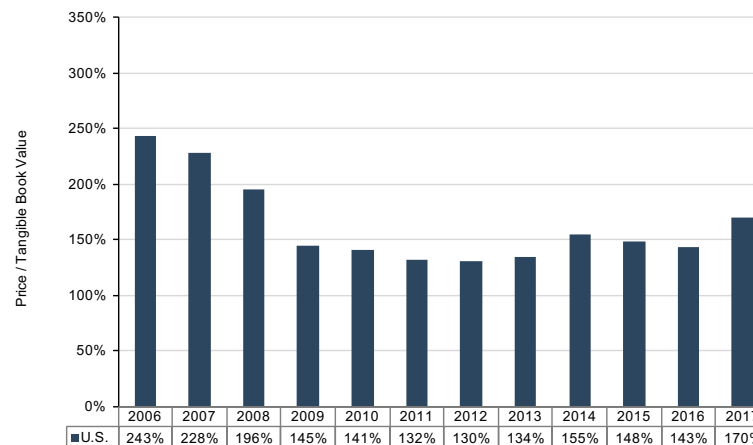
Median Price/Earnings Multiples

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



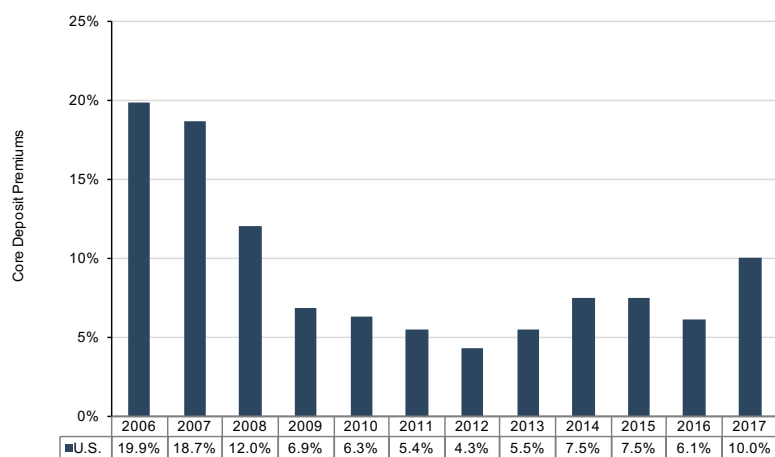
Median Price/Tangible Book Value Multiples

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

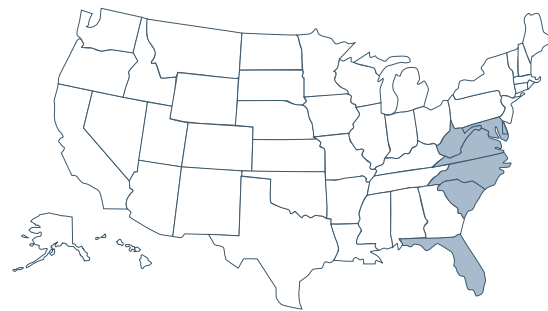
Target Banks' Assets <\$5B and LTM ROE >5%, 12 months ended December 2017

Regions	Price / LTM Earnings	Price/ Tang. BV	Price / Core Dep Premium	No. of Deals	Median Deal Value (\$M)	Target's Median Assets (\$000)	Target's Median LTM ROAE
Atlantic Coast	22.1x	175%	12.0%	21	89.1	545,116	8.4%
Midwest	19.1x	185%	10.8%	60	63.6	267,658	9.5%
Northeast	17.6x	158%	8.8%	8	52.4	422,000	6.9%
Southeast	17.8x	154%	8.0%	37	34.5	175,086	8.5%
West	20.2x	187%	11.2%	24	58.5	323,082	10.7%
National Community Banks	19.5x	170%	10.0%	150	58.5	272,058	9.1%

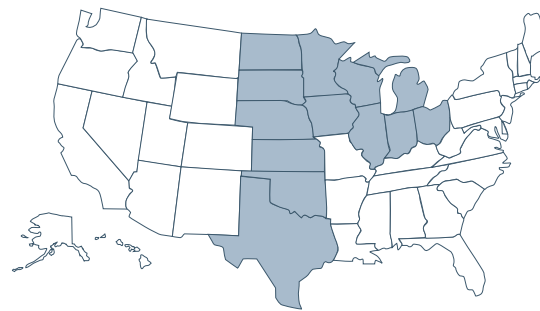
Source: S&P Global Market Intelligence

Mercer Capital's Regional Public Bank Peer Reports

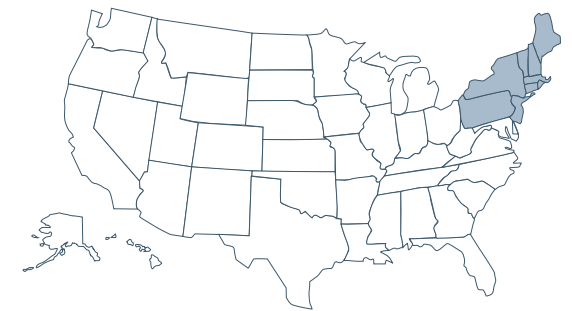
Updated weekly, Mercer Capital's Regional Public Bank Peer Reports offer a closer look at the market pricing and performance of publicly traded banks in the states of five U.S. regions. Click on the map to view the reports from the representative region.



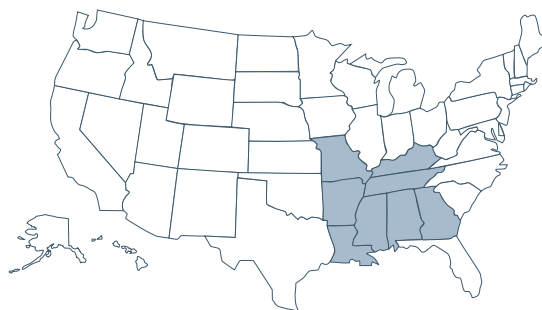
Atlantic Coast



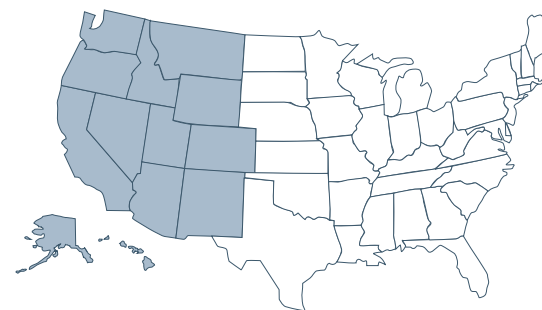
Midwest



Northeast



Southeast



West

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

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