October 11, 2017

CenterState Bank Corp. (CSFL)

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NAB Research, LLC
Distributed by Banks Street Partners, LLC

Price: $27.35
52-week price range: $17.72-$27.35
EPS Estimates: 2016A: $0.88
2017E: $1.42
2018E: $1.65
Q317E: **$0.35** (versus **$0.32** in 3Q16)
Tangible Book Value: $10.09
Price/TBV: 2.70x
Market Capitalization: $1.64 billion

- **This bank can now claim the title of "The Florida Consolidator"...**
- **CSFL has something that many community banks do not…Valuable sources of fee income...**
- **There will be a near-term impact from Hurricane Irma, but we do not foresee a change in the long-term growth dynamic in Florida...So, where does CenterState go next?**

Wow, has Florida changed…

That has been our reaction since we moved back to the Southeast and started spending time in Florida again—the Sunshine State has definitely changed. It may still be the slightly wild, slightly out-of-kilter place that we have known since childhood—where else can you find manatees and giant swamp pythons?—but it has a feel that is different from that of even a decade ago. Whether it was the searing experience of the housing downturn and the wave of home foreclosures that hit the state—that resulted in a short period during which Florida actually saw an out-migration of residents—or just the natural maturation of a state that has been devoted to growth for many decades, there is now a "normalcy" there that has not existed in past times. The relatively smooth handling of the widespread destruction from Hurricane Irma (more on that subject later) is to us evidence of a political process that has greatly matured in recent years, and our talks with bankers there have confirmed this perception.

And the banking scene is vastly changed in The Sunshine State, as well. We came of age as a bank analyst in the time when the big-bank dinosaurs roamed the Earth, and no state's bones got picked as clean as did those of Florida. **First Union, Trust Company of Georgia** and the then-**NationsBank** pretty much divided up the Florida world, with the purchase by NationsBank of the revered **Barnett Banks** in **August 1997**, (at a whopping 581% Price/TBV at announcement) marking the apotheosis of large Florida banking deals. The not-unusual result of this rapid consolidation was a chaotic banking environment, with customer losses and operational issues roiling the waters for several years.

The big banks still dominate the Florida deposit market share tables—but community banking is coming on strong. We are seeing the same evolution in Florida that we have seen in the upper Southeast, in places like Tennessee and the Carolinas. The community banks that survived the Financial Crisis have been able to acquire failed franchises, enjoy the benefits of purchase accounting accretion and acquired core deposits to power outsized earnings growth, and thus to attract investor attention and grow powerful stock valuations—and with this potent quiver of arrows to do deals and grow their franchises at a rapid pace.

There has now arisen a whole new category of community banks…
Due to this beneficent cycle of value creation, there is now a whole new category of community banks growing beyond the traditional community bank size and definition. Companies such as the Nashville-based **Pinnacle Financial Partners (PNFP),** Columbia, S.C.–based **South State Corp. (SSB),** and Georgia's **United Community Banks (UCBI)**—have already pushed beyond the $10 billion-in-assets size that has historically defined a community bank, and are simultaneously developing the business heft to be serious competitors to their larger regional brethren. Pinnacle Financial is providing an example for its Southeastern peers in its ability to attract lenders who are tired of the large-bank bureaucracy and are bringing with them sizable books of commercial business, and as the mega-community banks continue to grow we expect that the size and scope of their commercial relationships will continue to grow with them.

With their latest deals, CenterState has entered into this august company. CenterState management has just done something that we have seldom seen in our long career—**they have done a deal two-fer.** On August 14, the company announced that it would acquire both **HCBF Holding Co.** (parent of Harbor Community Banks of Fort Pierce, FL) and metro Tampa-based **Sunshine Bancorp (SBCP)** and in the process claim the title of the #1 Community Bank in Florida. These two banks will add $3.2 billion in assets and $2.0 billion in loans at a reasonable price—1.86x TBV combined—and will result in a modest 3% dilution to tangible book value.

There are several things that struck us immediately about the impact of these two deals. For one thing, CenterState will exceed the $10 billion-in-assets mark after these deals close in 1Q18 and will be able to **utilize the "mid-single digits" earnings accretion** that they expect to achieve here to absorb the roughly $10 million in pre-tax costs (increased FDIC expenses, the Durbin hit to debit revenues, and the costs of the DFAST regimen) that crossing this asset size entail. The company is assuming 40% cost saves—with half of these saves to be achieved in 2018—and will have a reasonable $35 million in after-tax merger costs to achieve these savings, with roughly $18.5 million to be expensed at the time of closing.

Secondly, based on the pro forma map of CSFL's branch network, this bank will be everywhere it needs to be in Florida. (The company will not be in the Florida Panhandle, which is widely regarded as an extension of the Alabama banking market.) CenterState will have an extensive presence on the east coast of Florida—from St. Augustine to The Keys—and will have a commanding presence in the Central Florida Interstate 4 corridor, stretching from Daytona Beach on the east to Tampa in the west. **In short, where the growth is in Florida—they'll be there.** And having grown from 37 branches in 2009 to 142 branches based on the pending transactions (all the while increasing deposits per branch from $27 million to $78 million), there should be little apprehension in the future as the company expands its presence to new areas.

There are a couple of particular attributes that strike us about CenterState…
In looking at this company's financials over the past few months, we have been struck by two things—the presence of meaningful sources of fee income in the revenue stream, and the inherent conservatism with which they approach their reporting. In the two years now that we have shifted our focus from observing the major banks to looking at community banks, we have encountered widely varying approaches to financial reporting and widely differing views on the importance of diversifying revenues away from an overwhelming reliance on net interest income. **We would most closely compare CenterState to South State in the integrity of their numbers and in their belief that they must grow fee-based revenues in tandem with their net interest revenues.**

While South State has a very large revenue contribution from asset and wealth management, CenterState's main source of fees comes from correspondent banking. This business (based in Atlanta, by the way) and its attendant capital markets revenues contributed roughly 50% of the company's fee revenue totals in 2Q17, and that level of contribution is consistent with prior quarters. The company provides correspondent services—fixed income trading, swaps, international services, cash management, and payments services, to name only a few—to roughly 600 banks throughout the nation, and it's not hard to envision the ways in which these correspondent relationships might be leveraged going forward. (Like in dialogues about mergers, perhaps?) And while wealth management is as yet a very small part of the fee income stream at CSFL, we would note that (as with South State) it is possible to build off a small base by acquiring banks that have established fiduciary operations and grow from there. CenterState's management has also expressed a desire to build out their mortgage banking operations (they have already built out a team in Atlanta) and that area of expertise would seem to us to be one that would be very compatible with and additive to their existing correspondent banking platform.

We appreciate their consistent messaging and their complete financial reporting. It makes it much easier for any bank analyst to track the growth of any fast-growing bank if the company's targets and goals stay consistent and if the presentation of the numbers is coherent, and we must say that CSFL's management could give lessons to some of their larger regional brethren in this regard. For example, the bank's CEO, John Corbett, began his August 14 presentation on the bank's two latest acquisitions with a straightforward statement of the company's goals in doing these deals: the acquisition of core deposits, which they believe are about to "become more scarce"; branch rationalization; the creation of Florida's leading bank in a climate where "bigger and better is best"; and meaningful accretion to future earnings. Hard to argue with any of those, and we don't expect to hear anything different in the announcements of future transactions.

And it always helps to not have to scramble for the numbers. We always do comparative statistical tables in the wake of quarterly earnings, and we can attest that it is very gratifying to find banks where we do not have to back into the numbers, go back to the annual report to find some credit quality trend, or otherwise have to bend into a pretzel to figure out what exactly happened in the quarter. CenterState's quarterly earnings reports are complete, they incorporate historical trends, and they are organized into consistent and logical segments.

And by the way—intentionally or not—their reporting style and rigor will make it much easier to see the impacts (both positive and negative) of acquired companies as they are layered in. We think that this demonstrated financial discipline is an important ingredient of bank stock valuation—and perhaps one not yet fully appreciated by some bank managements—and we hope that CSFL's community peers will take note.

What about the possible impacts of Hurricane Irma? While Irma—which was only a few weeks ago—has receded in the nation's consciousness in the midst of other more recent bad news, we expect that we will hear more about the hurricane's impacts when we begin the third quarter reporting season in a few days. The September jobs report on October 6—which reflected a loss of jobs and was largely impacted by hurricane activity—demonstrated the degree to which near-term economic trends may be distorted by the successive hits from Harvey and Irma, and we would expect that the Florida banks—large and small—will report some unusual trends as a result.

CenterState will report on October 25, and we may see some minor impacts. We checked in with the company in the wake of Irma, and received the positive message that they had "fared reasonably well", with any damage most pronounced in the Naples and The Keys markets. The company characterized its credit exposure in The Keys (which experienced the greatest destruction of structures) as around $70 million in a $7 billion loan portfolio. (The only possible issue for 3Q17 results would be the appearance of non-recurring expenses from any extraordinary efforts undertaken to provide customers and employees with services in the wake of the storm.)

We just don't see how long-term Florida growth trends as a whole are adversely impacted by the hurricane. Look, if the Financial Crisis didn't permanently sink Florida growth, it's hard for us to see how a storm—even a big one—reverses the growth trends that are in place there. Growth in the Sunshine State has long been powered by in-migration from the Northeast and the Midwest by those seeking a warmer climate and better tax treatment, and that's no longer just retirees. States like Illinois and New Jersey continue to bleed population as a result of mismanaged state budgets, and the departure of billionaire hedge fund manager David Tepper from New Jersey to Miami in 2016 (taking his billions in wealth and managed assets with him) is only one of the most prominent of these stories. While there may be individual communities in Florida that see population losses from the storm (most likely in The Keys) we expect the state overall to continue to gain population in coming years, and Irma will likely result in the mini-boom of construction that seems to naturally follow in the wake of these historic storms.

OK, here's the big question—does CenterState now take their act on the road?
We would say that answer would be "YES" and the next place that they go would most likely be our own home state of Georgia. Having reached the $10 billion mega-community size, it's hard to see how the management of CSFL does not take their very successful model to the next most logical place—the state contiguous to their own. Given that they have already established a business beachhead in Atlanta and given that the ATL market is one crying out for better relationship banking, we'd say that it is a safe bet that this is one market that they will be examining closely in coming months. We would also expect that the coastal areas of Georgia and the Carolinas—a logical northern progression from Jacksonville—would be particular areas of interest.

Let us make an intrepid statement here—this is a great bank, and let us also say that the stock's price increase of 50% over the past year probably reflects that fact. But we must also reflect that we are coming into a better interest rate environment for the banking industry, heightened commercial banking activity (particularly if there is progress on the tax front), and an environment that is particularly favorable for those community banks that have moved into this mega-community status from which they will go forward to do more (and likely larger) accretive deals. Get ready Pinnacle, South State and United Community—there's a new player in town, and they've got the strength of Florida behind them.

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Table 1
CenterState Bank Corp.
Earnings Estimates
($ Thousands, Except Per Share Data)

	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017E	2016A	2017E	2018E	Percent Change 17E/16A	18E/17E
Net Interest Income	**$45,802**	**$46,268**	**$48,570**	**$49,660**	**$62,526**	**$64,525**	**$182,784**	**$246,400**	**$354,900**	**35**	**44**
Tax Equivalent Adjustment	805	949	1,036	1,339	1,509	1,600	3,459	6,000	7,000	73	17
Loan Loss Provision	911	1,275	2,266	995	1,899	2,000	4,962	6,800	10,000	37	47
Subtotal	**44,086**	**44,044**	**45,268**	**47,326**	**59,118**	**60,925**	**174,363**	**233,600**	**337,900**	**34**	**45**
Noninterest Income											
Correspondent banking & related fees	9,291	7,528	8,091	6,449	8,063	8,000	33,685	32,500	34,000	(4)	5
Wealth management	795	892	815	893	891	850	3,237	3,300	4,000	2	21
Service charges	3,329	3,770	3,729	3,575	3,822	3,700	13,564	14,000	21,000	3	50
Card fees	2,182	2,017	2,009	2,265	2,324	2,400	8,254	9,200	10,000	11	9
BOLI Income	654	658	657	641	694	700	2,534	2,700	5,000	7	85
Other Noninterest Income	720	749	1,855	679	1,180	1,000	3,095	4,000	10,000	29	150
Total Noninterest Income	**16,971**	**15,614**	**17,156**	**14,502**	**16,974**	**16,650**	**64,369**	**65,700**	**84,000**	**2**	**28**
Noninterest Expense											
Employment Expenses	22,959	22,418	24,049	22,882	28,317	29,000	90,881	108,000	140,000	19	30
Occupancy Exp.	2,477	2,414	2,767	2,749	3,069	3,000	9,805	11,500	16,000	17	39
Depreciation expenses	1,588	1,629	1,659	1,684	1,837	2,000	6,373	7,500	9,000	18	20
Data Procesing	1,765	1,761	1,814	1,826	2,419	2,200	6,867	8,500	11,000	24	29
Professional Services	949	904	901	888	932	900	3,657	1,000	2,000	(73)	100
Amortization of intangibles	814	791	791	762	1,042	1,100	3,074	2,300	5,000	(25)	117
Credit related expenses	611	187	624	655	876	1,500	1,781	3,500	5,000	97	43
Merger related expenses	0	0	272	870	9,458	0	11,444	10,328	0	(10)	(100)
Other Expenses	5,886	6,224	5,307	5,727	6,859	7,500	40,599	29,000	40,000	(29)	38
Total Noninterest Exp.	**37,049**	**36,328**	**38,184**	**38,043**	**54,809**	**47,200**	**174,481**	**181,628**	**228,000**	**4**	**26**
Pretax Income	**24,008**	**23,330**	**24,240**	**23,785**	**21,283**	**30,375**	**64,251**	**117,672**	**193,900**	**83**	**65**
Income Taxes/(Benefit)	8,274	7,946	8,213	7,185	6,050	9,500	21,910	36,000	56,000	64	56
Net Income	**15,734**	**15,384**	**16,027**	**16,600**	**15,233**	**20,875**	**42,341**	**81,672**	**137,900**	**93**	**69**
Average Diluted Shares	48,454	48,603	48,800	51,408	59,370	59,500	48,192	57,445	82,000	19	43
Net Income per Dil. Share	**0.32**	**0.32**	**0.33**	**0.32**	**0.26**	**0.35**	**0.88**	**1.42**	**1.68**	**62**	**18**
Tax Rate	34.46	34.06	33.88	30.21	28.43	31.28	34.10	30.59	28.88	(10)	(6)
Adjusted Tax Rate	36.59	36.64	36.59	33.93	33.17	34.71	37.47	33.96	31.36	(9)	(8)
Net Interest Margin	**4.14%**	**4.12%**	**4.20%**	**4.28%**	**4.38%**	**4.45%**	**4.20%**	**4.40%**	**4.55%**	**5**	**3**
Average Earning Assets	4,449,381	4,467,735	4,605,713	4,704,187	5,730,431	5,800,000	4,356,455	5,600,000	7,800,000	29	39
Overhead Ratio %	59.0%	58.7%	58.1%	59.3%	68.9%	58.1%	70.6%	58.2%	51.9%	(18)	(11)
Tangible Book Value	**$8.64**	**$8.96**	**$8.93**	**$10.03**	**$10.09**	**$10.35**	**$8.93**	**$10.35**	**$12.03**	**16**	**16**
Revenues	62,773	61,882	65,726	64,162	79,500	81,175	247,153	312,100	438,900		
Fees as % of Total Revenue	**27.0**	**25.2**	**26.1**	**22.6**	**21.4**	**20.5**	**26.0**	**21.1**	**19.1**		

Dated: 10/10/17
NAB Research, LLC

Note: The 2018 estimate excludes roughly $51 million in pre-tax merger charges for HCBF Holdings and Sunshine Bancorp.

Table 2
CenterState Bank Corp.
Average Balance Sheet Summary
($ Thousands)

	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	% Change vs. Last Quarter	% Change vs. Last Year
Interest-Earning Assets							
Loans	**$2,950**	**$3,037**	**$3,161**	**$3,301**	**$4,236**	**28**	**44**
PCI loans	226	207	193	183			
Taxable Investment Securities	880	901	872	861	978	14	11
Non-Taxable Investment Securities	122	135	150	156	156	0	28
Total Investment Securities	**1,002**	**1,035**	**1,022**	**1,017**	**1,133**	**11**	**13**
Other interest-earning assets	**273**	**188**	**230**	**204**	**180**	(12)	(34)
Total Earning Assets	**4,449**	**4,468**	**4,606**	**4,704**	**5,730**	**22**	**29**
Interest-Bearing Liabilities							
Interest-Bearing Deposits	2,627	2,679	2,700	2,705	3,324	23	27
Fed Funds Purchased	189	181	274	260	254	(2)	35
Other borrowings	33	29	27	35	56	63	69
Corp. debentures	26	26	26	26	26	0	1
Total Interest-Bearing Liabilities	**2,874**	**2,914**	**3,026**	**3,025**	**3,661**	**21**	**27**
Non-interest bearing deposits	**1,507**	**1,445**	**1,455**	**1,508**	**1,892**	**25**	**26**
Net Interest Spread	**4.03%**	**4.00%**	**4.08%**	**4.15%**	**4.23%**		
Net Interest Margin	**4.14%**	**4.12%**	**4.20%**	**4.28%**	**4.38%**		

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