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# How Big Is Big Enough?

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We must admit that we did not foresee that we would be coming into the late stages of our banking investment career asking the same question that we were pondering as a junior analyst in the early 1980s: Just how big does a bank need to be?

It is, after all, a topic that has been of intense focus for investors and regulators alike since the days when regional interstate banking became a reality in 1985, resulting in the formation of regional powerhouse banks like **Fleet Financial Group** in the Northeast and **SunTrust Banks Inc. (STI)** in the Southeast. That initial period of regional consolidation was followed by the advent of nationwide banking in 1994—allowed by that august piece of legislation known as the Riegle-Neal Interstate Banking and Branching Efficiency Act—and by 1998, large-bank consolidation was off to the races nationally.

The purchase of **Bank of America Corp. (BAC)** by **NationsBank** in April 1998 created the first true transcontinental banking entity, and at almost the same time Sandy Weill of **Travelers/ Salomon Smith Barney** and John Reed of **Citibank** decided to stick their large thumb in the eye of the existing Glass-Steagall prohibitions through the formation of **Citigroup Inc. (C)**. In a notable recognition of reality, Congress then in 1999 repealed Glass-Steagall (which had been on the books since 1933) and a new era of banking size and revenue diversity was set loose.

The latest round of banking consolidation was set loose by the unfortunate events of 2008—we won't dwell on them here—as the healthy banks that emerged from the rubble were called upon to absorb a multitude of failed banks, especially here in the Southeast where large concentrations of commercial real estate loans had brought the community banking industry to its knees. The well-managed and generally larger banks—like **BNC Bancorp**, Tennessee's **Pinnacle Financial Partners (PNFP)**, South Carolina's **South State Corp. (SSB)**, Florida's **CenterState Bank Corp. (CSFL)**, and a host of others—discovered the riches to be mined from the careful management of troubled assets and have used those

enhanced revenues to buttress earnings and stock valuations and to acquire healthy banks in what can only be called an ongoing beneficent cycle. (Or in the case of BNC, to quickly grow large enough to become an attractive and significant acquisition target.)

25 Largest Domestic Banks								
Rank	Company Name	Ticker	12/31/18 Total Assets (\$mm)	2018 Loan Growth (%)	2018 ROAA (%)	2018 ROAE (%)	2018 Net Interest Margin (%)	2018 Efficiency Ratio (%)
1	JPMorgan Chase & Co.	JPM	2,622,532	5.89	1.24	12.71	2.50	57.7
2	Bank of America Corp.	BAC	2,354,507	1.05	1.21	10.63	2.43	58.2
3	Citigroup Inc.	C	1,917,383	2.48	0.94	9.03	2.75	58.2
4	Wells Fargo & Co.	WFC	1,895,883	(0.67)	1.21	11.25	2.91	64.8
5	U.S. Bancorp	USB	467,374	1.93	1.56	14.14	3.14	54.4
6	PNC Financial Services Group, Inc.	PNC	382,315	1.86	1.41	11.42	2.97	59.2
7	Capital One Financial Corp.	COF	372,538	(3.26)	1.66	11.98	6.87	53.7
8	Bank of New York Mellon Corp.	BK	362,873	(8.09)	1.24	10.20	1.25	67.0
9	State Street Corp.	STT	244,626	10.68	1.16	11.22	1.47	69.8
10	BB&T Corp.	BBT	225,697	3.58	1.47	10.95	3.46	56.9
11	SunTrust Banks, Inc.	STI	215,543	5.54	1.34	11.50	3.26	60.9
12	HSBC USA Inc.		172,448	(5.03)	0.18	1.60	1.42	75.5
13	MUFG Americas Holdings Corp.		168,100	8.29	0.65	5.67	2.25	77.7
14	Citizens Financial Group, Inc.	CFG	160,518	6.03	1.11	8.55	3.21	58.3
15	Fifth Third Bancorp	FITB	146,069	3.84	1.54	13.72	3.22	59.4
16	KeyCorp	KEY	139,613	3.76	1.35	12.33	3.18	62.0
17	CoBank, ACB		139,016	5.25	0.90	13.08	1.09	22.2
18	Northern Trust Corp.	NTRS	132,213	(0.26)	1.27	15.22	1.46	66.5
19	Regions Financial Corp.	RF	125,688	4.10	1.43	11.44	3.50	59.8
20	M&T Bank Corp.	MTB	120,097	0.55	1.64	12.27	3.83	55.0
21	Huntington Bancshares Inc.	HBAN	108,781	7.18	1.33	12.60	3.33	57.1
22	First Republic Bank	FRC	99,205	20.72	0.93	10.28	2.98	60.5
23	BBVA Compass Bancshares, Inc.	BBVA	90,947	5.79	0.85	5.75	3.30	63.1
24	Comerica Inc.	CMA	70,818	2.13	1.75	15.82	3.60	51.7
25	Zions BanCorp., National Assoc.	ZION	68,746	4.53	1.33	11.65	3.61	59.7

Source: S&P Global Market Intelligence

While the deals of 2008-2010 may have been designed for the primary purpose of stabilizing the banking industry – we would point to the absorption of the de facto failed **Wachovia** by **Wells Fargo & Co. (WFC)** as perhaps the industry’s foremost instance of systemic stabilization – the underlying logic for deal-making remains the same as it was since industry consolidation began in the 1980s. It is simply the need to spread the fixed costs of banking over a larger customer base, and while there are ancillary reasons to do deals – such as the need to diversify geographic risk or to seek a stable base of core funding – it is hard to see the rationale for any bank deal that does not involve a large component of cost-cutting.

Those cost saves may give an impetus to earnings, but it is increasingly necessary to redirect a large portion of savings back toward reinvestment in technology, and this is where the Brave New World of banking comes into play. While the banking industry has come a long, long way in its uses of

technology of all types – and most prominently in development of technologies that allow customers to transact business from just about anywhere – there is nonetheless the reality of a shadow banking sector that will be nipping at the heels of regulated banks in the coming years with their ability to use specialized technologies to pick off desirable chunks of business. In addition, the coming of 5G networks and the rising uses of AI (especially for back office and call center functions) pretty much promise that the need for investment in new technologies will likely only accelerate in coming years.

25 Largest Banks - Southeast								
Rank	Company Name	Ticker	12/31/18 Total Assets (\$mm)	2018 Loan Growth (%)	2018 ROAA (%)	2018 ROAE (%)	2018 Net Interest Margin (%)	2018 Efficiency Ratio (%)
1	Bank of America Corp.	BAC	2,354,507	1.05	1.21	10.63	2.43	58.2
2	Capital One Financial Corp.	COF	372,538	(3.26)	1.66	11.98	6.87	53.7
3	BB&T Corp.	BBT	225,697	3.58	1.47	10.95	3.46	56.9
4	SunTrust Banks, Inc.	STI	215,543	5.54	1.34	11.50	3.26	60.9
5	Regions Financial Corp.	RF	125,688	4.10	1.43	11.44	3.50	59.8
6	First Horizon National Corp.	FHN	40,832	(0.48)	1.38	12.05	3.45	63.6
7	First Citizens BancShares, Inc.	FCNC.A	35,409	8.19	1.15	11.70	3.69	66.0
8	Synovus Financial Corp.	SNV	32,669	4.62	1.35	14.29	3.82	55.6
9	BankUnited, Inc.	BKU	32,164	2.81	1.05	10.57	3.67	61.6
10	Hancock Whitney Corp.	HWC	28,236	5.49	1.17	11.04	3.38	56.8
11	Pinnacle Financial Partners, Inc.	PNFP	25,031	12.61	1.53	9.37	3.60	46.2
12	Bank OZK	OZK	22,388	6.69	1.90	11.58	4.59	35.6
13	United Bankshares, Inc.	UBSI	19,250	2.99	1.36	7.84	3.57	49.4
14	BancorpSouth Bank	BXS	18,002	18.58	1.28	10.60	3.72	65.8
15	Simmons First National Corp.	SFNC	16,543	8.65	1.37	10.00	3.97	53.1
16	Home BancShares, Inc.	HOMB	15,302	7.26	2.06	13.17	4.42	37.6
17	South State Corp.	SSB	14,676	3.18	1.23	7.63	4.09	56.6
18	Union Bankshares Corp.	UBSH	13,766	35.43	1.11	7.85	3.74	54.6
19	Trustmark Corp.	TRMK	13,286	0.95	1.11	9.43	3.54	66.1
20	Renasant Corp.	RNST	12,935	22.95	1.32	8.64	4.16	58.9
21	United Community Banks, Inc.	UCBI	12,573	8.19	1.35	12.04	3.91	55.0
22	WesBanco, Inc.	WSBC	12,459	20.58	1.26	8.68	3.52	53.0
23	CenterState Bank Corp.	CSFL	12,338	75.23	1.43	9.41	4.39	50.5
24	Ameris Bancorp	ABCB	11,444	38.22	1.24	10.27	3.92	54.4
25	TowneBank	TOWN	11,163	31.73	1.30	9.47	3.61	62.1

Source: S&P Global Market Intelligence

Is there a magic asset size that will ensure the ability to afford new technology? Not that we can find. The recently announced mega-merger between **BB&T Corp. (BBT)** and SunTrust was apparently conceived in part to enable enhanced spending on technology at legacy SunTrust and then to allow the new (as-yet unnamed) entity to become a technology leader among the large regional banks. On the other end of the size spectrum, banks are doing mergers with the \$5 billion-in-assets goal in mind to allow for enhanced delivery of deposit products – like remote deposit capture, among others – and to develop enhanced treasury management capabilities for commercial customers. It seems to us that there is increasingly a basic suite of products – all of which must be delivered without physical infrastructure – without which a bank cannot really be functional, much less be successful.

We want to discuss one final issue that has arisen in the last few months related to merger activity that is beginning to be addressed by the Southeast's fastest growing community banks—the issue of purchase accounting accretion. We must admit that, as an analyst who had spent most of our career analyzing large banks, we had not spent a great deal of time thinking about the subject, as it tended to be not material to the earnings of our monitored companies. The acquisition of the asset-troubled Wachovia by Wells Fargo changed that fact, and indeed the enhanced cash flows from the large portfolio of non-conforming mortgages and other marked-down assets on Wachovia's books have accreted over \$20 billion (pre-tax) into Wells Fargo's net interest income and fee income during the period from 2009-2018.

25 Largest Banks - Mid-Atlantic								
Rank	Company Name	Ticker	12/31/18 Total Assets (\$mm)	2018 Loan Growth (%)	2018 ROAA (%)	2018 ROAE (%)	2018 Net Interest Margin (%)	2018 Efficiency Ratio (%)
1	JPMorgan Chase & Co.	JPM	2,622,532	5.89	1.24	12.71	2.50	57.7
2	Citigroup Inc.	C	1,917,383	2.48	0.94	9.03	2.75	58.2
3	PNC Financial Services Group, Inc.	PNC	382,315	1.86	1.41	11.42	2.97	59.2
4	Bank of New York Mellon Corp.	BK	362,873	(8.09)	1.24	10.20	1.25	67.0
5	HSBC USA Inc.		172,448	(5.03)	0.18	1.60	1.42	75.5
6	MUFG Americas Holdings Corp.		168,100	8.29	0.65	5.67	2.25	77.7
7	M&T Bank Corp.	MTB	120,097	0.55	1.64	12.27	3.83	55.0
8	New York Community Bancorp, Inc.	NYCB	51,899	4.55	0.84	6.23	2.24	48.7
9	CIT Group Inc.	CIT	48,537	(0.85)	0.93	6.75	3.41	54.3
10	Popular, Inc.	BPOP	47,605	6.87	1.33	11.36	4.34	56.9
11	Signature Bank	SBNY	47,365	11.66	1.12	12.17	2.93	36.7
12	F.N.B. Corp.	FNB	33,102	5.16	1.16	8.30	3.38	54.9
13	Valley National Bancorp	VLY	31,863	36.72	0.86	7.91	3.11	58.8
14	Sterling Bancorp	STL	31,383	3.77	1.45	10.30	3.56	38.7
15	Investors Bancorp, Inc.	ISBC	26,229	7.68	0.80	6.57	2.73	55.9
16	Fulton Financial Corp.	FULT	20,682	2.58	1.03	9.24	3.40	65.4
17	First BanCorp.	FBP	12,244	0.62	1.65	10.56	4.74	53.7
18	Community Bank System, Inc.	CBU	10,607	0.36	1.58	10.20	3.73	57.2
19	Customers Bancorp, Inc.	CUBI	9,833	(1.90)	0.69	7.61	2.58	63.7
20	Provident Financial Services, Inc.	PFS	9,726	(0.97)	1.22	8.93	3.37	53.1
21	Northwest Bancshares, Inc.	NWBI	9,608	3.36	1.11	8.61	3.88	62.3
22	NBT Bancorp Inc.	NBTB	9,556	4.71	1.20	11.49	3.58	58.5
23	Eagle Bancorp, Inc.	EGBN	8,389	8.93	1.91	14.89	4.10	37.3
24	Sandy Spring Bancorp, Inc.	SASR	8,243	52.87	1.27	9.84	3.61	51.1
25	First Commonwealth Financial Corp.	FCF	7,828	6.78	1.42	11.41	3.71	57.1

Source: S&P Global Market Intelligence

While nothing in the mega-community segment in the Southeast approaches that level of magnitude, there are nonetheless several banks—Pinnacle Financial, **State Bank Financial**, and **Ameris Bancorp (ABCB)** come most readily to mind—where accretion has been a material factor in the difference between reported net interest margin and core NIM and has been important to earnings trends and stock valuation in the past several years. Robert Hill, CEO of South State, has taken the occasion of a recent meeting with analysts and his commentary on the company's 4Q18 earnings call to address the

issue of accreted revenues and how they should play into future earnings expectations and stock valuation.

As Mr. Hill stated on SSB's January 29 earnings call: "Accretion is not free..." We think that those words and the theory behind them deserve some contemplation and explanation. Indeed, our understanding of the accounting underpinnings of accreted earnings is that these are cash flows that recognize the expenses inherent in getting these assets back to full productivity and in getting an acquired bank up to the credit and technological profile of the acquirer. In short, accreted earnings fill the time and expense void that is naturally created by any deal and help to alleviate the earnings shortfall as an acquired franchise is integrated and perfected.

25 Largest Banks - Southwest								
Rank	Company Name	Ticker	12/31/18 Total Assets (\$mm)	2018 Loan Growth (%)	2018 ROAA (%)	2018 ROAE (%)	2018 Net Interest Margin (%)	2018 Efficiency Ratio (%)
1	CoBank, ACB		139,016	5.25	0.90	13.08	1.09	22.2
2	BBVA Compass Bancshares, Inc.		90,947	5.79	0.85	5.75	3.30	63.1
3	Comerica Inc.	CMA	70,818	2.13	1.75	15.82	3.60	51.7
4	Zions BanCorp., National Assoc.	ZION	68,746	4.53	1.33	11.65	3.61	59.7
5	BOK Financial Corp.	BOKF	38,021	25.98	1.28	11.94	3.19	61.0
6	Cullen/Frost Bankers, Inc.	CFR	32,293	7.52	1.47	13.85	3.64	55.3
7	IBERIABANK Corp.	IBKC	30,833	12.03	1.25	9.54	3.75	55.0
8	Texas Capital Bancshares, Inc.	TCBI	28,258	13.23	1.19	12.72	3.75	52.6
9	Prosperity Bancshares, Inc.	PB	22,693	3.49	1.42	8.15	3.18	42.6
10	Hilltop Holdings Inc.	HTH	13,684	1.93	0.93	6.51	3.56	86.6
11	Cadence BanCorp.	CADE	12,730	21.78	1.45	12.07	3.61	48.6
12	International Bancshares Corp.	IBOC	11,872	3.49	1.81	11.63	3.98	50.5
13	Independent Bank Group, Inc.	IBTX	9,850	21.65	1.35	8.69	3.99	49.5
14	LegacyTexas Financial Group, Inc.	LTXB	9,051	(0.50)	1.73	15.22	3.89	44.8
15	First Financial Bankshares, Inc.	FFIN	7,732	13.66	1.98	15.37	3.96	48.7
16	BancFirst Corp.	BANF	7,574	5.48	1.66	14.59	3.70	56.0
17	Southside Bancshares, Inc.	SBSI	6,123	0.33	1.19	9.87	3.18	49.9
18	National Bank Holdings Corp.	NBHC	5,677	30.21	1.10	9.28	3.93	65.7
19	Origin Bancorp, Inc.	OBNK	4,822	16.45	1.16	10.07	3.75	66.1
20	Allegiance Bancshares, Inc.	ABTX	4,655	63.85	1.11	9.02	4.27	59.5
21	Triumph Bancorp, Inc.	TBK	4,560	28.33	1.33	9.24	6.35	61.6
22	CBTX, Inc.	CBTX	3,279	5.90	1.50	10.18	4.35	57.9
23	Veritex Holdings, Inc.	VBTX	3,209	14.22	1.26	7.73	4.09	46.8
24	Guaranty Bancshares, Inc.	GNTY	2,267	22.05	0.97	9.03	3.50	65.2
25	People's Utah Bancorp	PUB	2,184	2.71	1.87	14.85	5.31	49.7

Source: S&P Global Market Intelligence

We have a suggestion for the mega-consolidating community banks and for the next generation that is coming along behind them. We believe that accreted earnings would be more highly valued and subject to less suspicion on the part of investors if they were explained more fully within the context of the human effort and technological expense that is required to produce them. Indeed, accretion is

not free – we equate it with “sweat equity” on the part of a homeowner – and analysts and investors see little of the effort that goes on behind the numbers. Perhaps that condition needs to change.

So much for philosophical musings – now back to our initial question. How big is big enough? It is beginning to dawn on us that we will conclude our career without ever having found the answer to that puzzle. Instead, it is beginning to dawn upon us that we are asking the wrong question altogether. Instead of asking any banker what size he wants his bank to be, we should be asking the question: Who are the customers that you want, and what do you have to do to get them?

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