

Branch deals about core deposits and lending profitability — not buildings

By Kevin Dobbs and Venkatesh Iyer January 29, 2016

In an era when customers are increasingly doing more of their banking business via digital means, many banks are actively downsizing the size and number of their branches via closings and sales.

SNL Financial data showed that the U.S. banking sector finished 2015 with 92,997 branches, 1,614 fewer than a year earlier. That extended a trend that dates to 2009.

But there is more to this story.

As banks unload branches, other lenders step in and buy certain locations put on the sale block — often to pick up prized low-cost deposits in anticipation of a rising interest rate environment, as opposed to simply seeking out a physical presence in a given area.

Federal Reserve policymakers in December 2015 raised short-term rates for the first time since prior to the 2008 fi-

ancial crisis, and they signaled that more hikes could follow in 2016. While policymakers left rates steady following their January meeting — its targeted federal funds rate hovers between 0.25% and 0.50% — they left additional, gradual rate increases on the table for the year ahead.

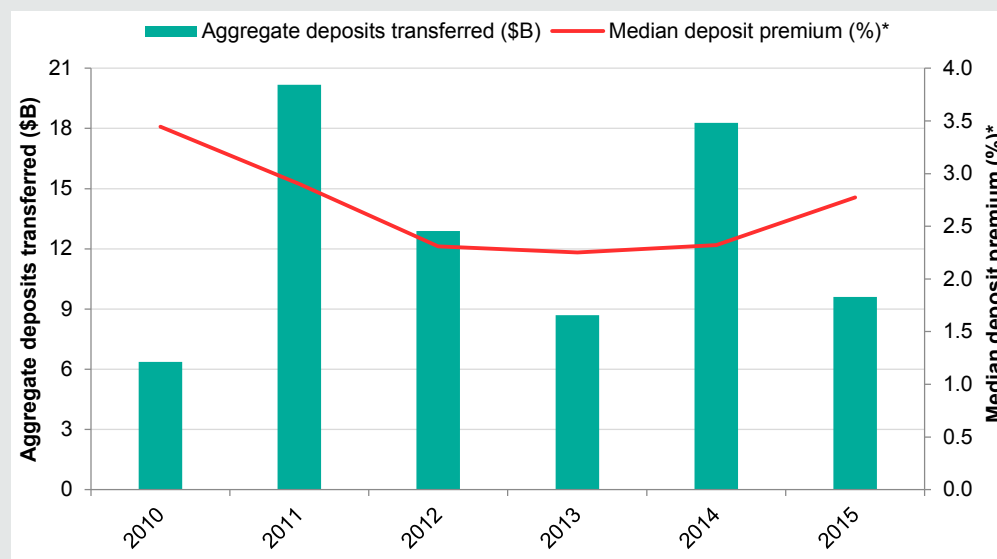
That leaves bankers anticipating a higher rate environment, and those with ambitions of strong loan growth this year and beyond say that makes inexpensive deposits all the more valuable. Banks with lower funding costs — high levels of core deposits — are often best positioned to follow Fed rates hikes with rate increases on loans that are greater than bumps they may have to make to on deposits, helping boost the profitability of lending.

"I do think a lot of bankers are gearing up for that," Jacob Thompson, a managing director of investment banking at SAMCO Capital Markets, told SNL.

That helps explain why deposit premiums paid on branch deals climbed in 2015, he said. An SNL analysis of U.S. bank and thrift branch deals found that the median deposit premium approached 3% last year, up from each of the three previous years, when the median level hung below 2.5%.

South State Corp.'s acquisition of 13 Bank of America Corp. branches in 2015 encapsulates this development. The Columbia, S.C.-based bank picked up nearly \$440 million in

Aggregate deposits transferred and median deposit premiums in US branch deals since 2010



Data compiled Jan. 23, 2016.

Includes bank and thrift branch deals with target branches based in the U.S. announced from 2010 to 2015.

* Represents the median deposit premium at announcement for U.S. branch deals on an annual basis since 2010.

Source: SNL Financial



15 most expensive branch deals announced in 2015

Ranked by franchise premium/deposits

Announcement date	Completion date	Buyer		Seller		Target branch states (#)	Franchise premium/deposits (%)*	Deposits transferred (\$M)
		Company (ticker)	City, state	Company (ticker)	City, state			
04/22/15	08/21/15	South State Corp. (SSB)	Columbia, SC	Bank of America Corp. (BAC)		GA (1), SC (12)	5.50	580.0
05/11/15	08/10/15	American State Bancshares Inc.	Wichita, KS	Simmons First National Corp. (SFNC)		KS (3)	4.00	80.0
09/30/15	Pending	Great Southern Bancorp Inc. (GSBC)	Springfield, MO	Fifth Third Bancorp (FITB)		MO (12)	3.70	260.3
01/30/15	08/14/15	First Mid-Illinois Bancshares Inc. (FMBH)	Mattoon, IL	Old National Bancorp (ONB)		IL (12)	3.62	502.0
12/17/15	Pending	Athens Bancshares Corp. (AFCB)	Athens, TN	Atlantic Capital Bancshares Inc. (ACBI)		TN (4)	3.50	104.0
01/30/15	08/14/15	MainSource Financial Group Inc. (MSFG)	Greensburg, IN	Old National Bancorp (ONB)		IN (3), OH (1)	3.42	120.0
01/29/15	06/12/15	Ameris Bancorp (ABCB)	Moultrie, GA	Bank of America Corp. (BAC)		FL (8), GA (10)	3.00	866.9
10/15/15	Pending	Seacoast Banking Corp. of Florida (SBCF)	Stuart, FL	Bank of Montreal (BMO)		FL (14)	3.00	355.4
10/28/15	Pending	Bank of Commerce Holdings (BOCH)	Redding, CA	Bank of America Corp. (BAC)		CA (5)	2.83	258.0
05/27/15	09/18/15	F.N.B. Corp. (FNB)	Pittsburgh, PA	Bank of America Corp. (BAC)		PA (5)	2.80	275.5
06/01/15	10/13/15	BNC Bancorp (BNCN)	High Point, NC	CertusHoldings Inc.		SC (7)	2.75	284.4
03/30/15	08/07/15	Max Bancorp LLC	North Myrtle Beach, SC	HCSB Financial Corp. (HCFB)		SC (3)	2.50	41.0
09/01/15	Pending	FS Bancorp Inc. (FSBW)	Mountlake Terrace, WA	Bank of America Corp. (BAC)		WA (4)	2.50	268.0
10/28/15	Pending	Cascade Bancorp (CACB)	Bend, OR	Bank of America Corp. (BAC)		OR (12), WA (3)	2.00	707.0
10/28/15	Pending	TriCo Bancshares (TCBK)	Chico, CA	Bank of America Corp. (BAC)		CA (3)	1.91	245.0
Median for 2015 U.S. bank and thrift branch deals[^]							2.80	268.0

Includes bank and thrift branch deals announced in 2015, with three or more U.S. target branches and available deposit premium data. The deposits transferred are as at announcement.

* Franchise premium/deposits = deal premium, as a percentage of deposits, at the time of announcement

[^] Medians based on deals with three or more U.S. target branches where franchise premium/deposits is available.

Ticker is based on the home country of the highest traded entity within the corporate structure.

Source: SNL Financial



core deposits via the deal — this was the final level following closing — and paid up to get them.

The franchise premium paid on the deposits in that deal — deal premium as a percentage of deposits at announcement — was 5.5%, the highest of all branch deals involving three or more locations last year, according to SNL data.

But South State COO and CFO John Pollok told SNL that the branches were about 40 years old and were loaded with deposits from customers who had long parked their money at those locations. “We paid a pretty high premium,

but those deposits are very, very sticky,” Pollok said. “We’re a big believer in core deposits.”

The bank also believes that it, like most of its peers, ultimately needs fewer branches. That, Pollok said, is why South State made a plan to consolidate six overlapping branches tied to the BofA deal. It was part of a broader effort to bring down branch numbers and drive in-person business to select locations where foot traffic remains high enough to make the branches profitable.

So even as it buys branches, South State looks to shutter or sell some of them off later — after it has established itself

15 most expensive bank and thrift whole deals announced in 2015

Ranked by tangible book premium/core deposits

Announcement date	Completion date	Buyer		Seller		Tangible book premium/core deposits (%)*	Target total deposits (\$M)	No. of target branches
		Company (ticker)	City, state	Company	City, state			
10/14/15	12/22/15	Citizens Bancshares of Batesville Inc.	Batesville, AR	Parkway Bankshares Inc.	Portland, AR	25.89	102.2	5
12/07/15	Pending	BBCN Bancorp Inc. (BBCN)	Los Angeles, CA	Wilshire Bancorp Inc.	Los Angeles, CA	22.85	3,942.4	35
11/09/15	Pending	United Bankshares Inc. (UBSI)	Charleston, WV	Bank of Georgetown	Washington, DC	20.48	959.1	11
03/02/15	10/06/15	PacWest Bancorp (PACW)	Los Angeles, CA	Square 1 Financial Inc.	Durham, NC	19.75	2,776.6	1
04/07/15	07/31/15	Pinnacle Financial Partners Inc. (PNFP)	Nashville, TN	CapitalMark Bank & Trust	Chattanooga, TN	18.43	780.5	4
11/09/15	Pending	Bank of the Ozarks Inc. (OZRK)	Little Rock, AR	C1 Financial Inc.	Saint Petersburg, FL	18.31	1,264.4	31
10/19/15	Pending	Bank of the Ozarks Inc. (OZRK)	Little Rock, AR	Community & Southern Holdings Inc.	Atlanta, GA	18.26	3,058.7	48
01/06/15	05/31/15	Chemical Financial Corp. (CHFC)	Midland, MI	Lake Michigan Financial Corp.	Holland, MI	18.04	998.7	5
12/14/15	Pending	Franklin Financial Network Inc. (FSB)	Franklin, TN	Civic Bank & Trust	Nashville, TN	17.77	105.2	2
01/21/15	07/31/15	Cathay General Bancorp (CATY)	Los Angeles, CA	Asia Bancshares Inc.	Flushing, NY	17.06	418.2	5
10/01/15	Pending	Ameris Bancorp (ABCB)	Moultrie, GA	Jacksonville Bancorp Inc.	Jacksonville, FL	17.03	426.2	9
03/09/15	06/30/15	Western Alliance Bancorp. (WAL)	Phoenix, AZ	Bridge Capital Holdings	San Jose, CA	15.58	1,549.5	1
06/17/15	10/01/15	Home BancShares Inc. (HOMB)	Conway, AR	Florida Business BancGroup Inc.	Tampa, FL	15.46	425.3	6
08/17/15	Pending	BB&T Corp. (BBT)	Winston-Salem, NC	National Penn Bancshares Inc.	Allentown, PA	15.43	6,733.5	129
12/30/15	Pending	Emclave Financial Corp. (EMCF)	Emlenton, PA	United-American Savings Bank	Pittsburgh, PA	15.32	74.5	1
Median for 2015 U.S. bank and thrift whole deals						5.66	127.2	3

Data compiled Jan. 23, 2016.

Includes bank and thrift whole deals announced in 2015, with the seller based in the U.S.

Excludes government-assisted deals.

* Tangible book premium/core deposits = deal premium, as measured against tangible book value, as a percentage of core deposits, at announcement

Source: SNL Financial



with customers at those branches and after it is comfortable it will retain the vast majority of core deposits acquired, Pollok said.

"Those core deposits, they are the main focus of our strategy," he said.

Pollok said South State has a history of steadily growing loans, so it needs to continue to bolster its low-cost funding base to both fuel that lending and maximize its profitability. That thinking gets amplified as interest rates rise, he noted,

which is another reason South State was eager to seal the deal with BofA. It joined much of the industry at the time in anticipating that a shift in the rate environment was inevitable. The December rate increase proved them right.

Pollok said South State has a roughly 85% loan-to-deposit ratio. The favorable level means that, unlike competitors with lower funding bases and higher loan-to-deposit ratios, South State does not have to borrow to fund loan growth, demonstrating that its focus on core deposits gives it an

advantage and helps it to compete with larger banks, Pollok said.

“Our No. 1 goal has been getting those core deposits,” he said.

The same thinking was often applied to whole-bank acquisitions in 2015. A case in point: PacWest Bancorp’s acquisition of Square 1 Financial Inc.

Assessing deals on the basis of deal premium measured against tangible book value as a percentage of core deposits at announcement, PacWest’s play for Square 1 was among the most expensive acquisitions of 2015, according to SNL data. And Square 1, a venture capital-focused bank, brought only one branch to the deal table.

But it also brought a dozen loan-production offices nationally and a wealth of low-cost deposits. At the time of the deal announcement, nearly half of its \$2.8 billion in deposits were noninterest bearing. So the acquisition gave Los Angeles-based PacWest both new lending opportunities and low-cost funding to help drive it, and it better positioned the buyer for an eventual shift upward in the rate environment, analysts told SNL after that deal was inked in 2015.

All of that noted, two important questions loom large: When will the Fed move to further raise rates? And how

much do rates need to rise for lenders to show substantial gains in their net interest margins?

SAMCO’s Thompson emphasized that any answer to the first question is merely a guess, given that Fed policymakers have said future increases are dependent on consistently solid economic data. The domestic energy sector is slumping amid low oil prices; global economic conditions are fragile; and rocky stock markets point to concerns about slowdowns in Europe and Asia infecting the U.S.

But, the U.S. job market remains on solid ground, as Thompson noted, and Fed officials anticipate upward momentum in inflation. If employment levels remain strong and inflation starts to pick up, policymakers could potentially move on rates multiple times before 2016 is over.

Many bankers say that, on top of the 25 basis-point increase in rates that the Fed initiated in December, they would need to see at least two more similar hikes, perhaps three, to really show substantial benefits from higher rates. Count Bank of Hawaii Corp. Chairman, President and CEO Peter Ho among them.

“We haven’t seen much of an impact yet,” Ho told SNL. “Every little bit helps, but if we can get up to a cumulative increase of 100 [basis points], that’s when we’d see meaningful impact.”