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Could Frost Bank be a buyer or seller?

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SunTrust Robinson Humphrey analyst Jennifer Demba mentions Frost Bank as both a potential acquirer and target for acquisition in research note issued Tuesday. Pictured is a view of the new Frost Tower, left, from the Hays Street Bridge as an Air Force C-5 transport plane cruises in the distance.

Photo: Kin Man Hui /Staff photographer

The mergers and acquisitions activity shaking up the banking industry has sparked speculation that San Antonio's Frost Bank could join the party — as either a buyer or seller.

Frost was among seven institutions identified as “attractive franchises” on the mergers and acquisitions, or M&A, front by SunTrust Robinson Humphrey analyst Jennifer H. Demba in a Tuesday research note to investors.

“Given the positive stock reactions from larger bank M&A announced in 2019, we may see more partnerships,” she said in the note.

Other financial analysts, though, expressed skepticism that Frost parent Cullen/Frost Bankers Inc. is in the market to acquire another bank or sell itself. With \$32.3 billion in assets as of Dec. 31, Frost is the largest regional bank based in San Antonio.

Talk of industry consolidation comes as regional banks look to increase in size as oversight from financial regulators eases under the Trump administration, professional-services firm EY reported recently.

“Right now, all of the lights on the banking dashboard are green,” said Curtis Carpenter, principal and head of investment banking at Austin-based Sheshunoff & Co. Investment Banking.

Carpenter attributed bankers’ M&A interest to less stringent regulatory oversight, the corporate tax rate falling from 35 percent to 21 percent, the highest credit quality for banks in more than a decade, and their expanding net interest margins — which measures the difference between what banks collect on loans and what they pay on deposits.

While the number of mergers and acquisitions in the U.S. financial services industry was relatively flat in the first 11 months of last year versus the same period in 2017, the dollar volume of the deals surged by 139 percent to \$196.5 billion last year, according to EY.

“The financial services industry is bullish on M&A, and U.S. companies are even more confident than what we are seeing globally,” Nadine Mirchandani, EY Americas Financial Services Leader, Transaction Advisory Services, said in the report.

This month, BB&T announced it would buy SunTrust Banks for \$28 billion in stock to create the country’s sixth largest lender, with assets of about \$442 billion. BB&T, which has local branches, is based in Winston-Salem, N.C. SunTrust is based in Atlanta.

Locally, San Antonio’s Vantage Bank Texas and McAllen’s Inter National Bank completed a merger in November. The combined banks, which now operate under the Vantage name, have about \$1.9 billion in assets. The deal was unusual in that both banks had common ownership.

In addition, The First National Bank of Beeville is in the process of being acquired by Conroe’s Spirit of Texas Bank in a deal valued at almost \$64 million.

'Buying power'

Demba of SunTrust ranked Frost second among 20 banks with the strongest buying power. She based that on the banks' share price to tangible book value a share, which measures the value of a company's assets, excluding intangible assets such as goodwill.

Demba considered multiple merger scenarios without addressing the merits of any specific transactions.

She identified three publicly traded financial institutions — Houston's Prosperity Bancshares Inc., BOK Financial Corp. of Tulsa and Hancock Whitney of Gulfport, Miss. — as potential targets for Frost.

At the same time, Demba said Frost may be an ideal addition for BOK Financial, parent of Bank of Oklahoma and Bank of Texas, among other banks.

Demba was not available for comment, but other analysts weighed in on the possibility of Frost being a player in the M&A arena.

Frost is considered a crown jewel among Texas banks. It's operated for about 150 years and has a solid reputation based on its conservative management and distinct culture, analysts say. So there would likely be plenty of interested buyers lined up if Frost put up a for sale sign.

But ...

"I just don't see them as a willing seller," Peter J. Winter, managing director of Wedbush Securities, said.

"Banking is very different than any other industry," he added. "Banks are really sold. They're not bought. So you need a willing seller, and I just don't see that" with Frost.

It would take a very high price to acquire Frost, Sheshunoff's Carpenter said.

"Since Frost already trades at such a high price to pay them a price sufficiently above their trading price to entice them into a deal would take a very powerful buyer, indeed," Carpenter said.

Cullen/Frost's shares closed at \$105.28 Friday.

If any bank deserves a high price, it would be Frost, he added. But he said it would be difficult for a publicly traded bank to offer that much and “not get punished” by investors.

Cullen/Frost Chairman and CEO Phil Green has been at the helm for just under three years, so it's unlikely he'd want to sell, said Brady Gailey, a securities analyst with Keefe, Bruyette & Woods in Atlanta.

Houston expansion

Also, Frost recently announced plans to nearly double its presence in the Houston area by opening 25 branches — a 19 percent increase of its branch network. It expects to add 260 jobs.

On ExpressNews.com: Frost Bank plans major Houston expansion

“Clearly, you would not announce this Houston expansion and then turn around and sell the company,” Gailey said. “This Houston expansion is ... dilutive (to earnings per share) in the near term and generally you don't do stuff like this when you're about to sell the company.”

Frost spokesman Bill Day had no comment on Demba's note mentioning the bank as a potential target for acquisition.

On the flip side, the Houston expansion may also be a signal that Frost isn't looking to buy.

There are a handful of Houston banks with \$1 billion to \$5 billion in assets that would make a “great size acquisition for Frost,” Gailey said, yet Frost elected not to buy any of them.

Carpenter agreed, saying Post Oak Bancshares was “about as perfect a match for Frost Bank as a bank could be.” Both banks have relationship-based business models and solid, conservative lending styles, he said. Allegiance Bancshares, also based in Houston, acquired Post Oak in October.

During a third-quarter conference call, Wedbush's Winter asked Green about Frost's strategy to expand in Houston by opening branches rather than acquiring another bank.

“Am I going to take (a) 150-year company, with the kind of valuation quality we have, and just give X percent of it to someone because they put together a few branches and hired a few lenders, just so I can get bigger in a market I'm already in?” Green said, according to a transcript.

“I’m convinced that we build greater shareholder value if we can grow it organically” by opening branches, he added. “I don’t want to ... give the impression that ... I hold acquisitions in contempt. It’s just, to me and to our team, when you’ve got the ability to grow organically and you’re in fantastic markets — and we are in Texas — let’s leverage that. That’s the way to create value.”

‘Conservative buyers’

It’s been almost five years since Frost has made a bank acquisition. It acquired Odessa-based WNB Bancshares, the parent of Western National Bank, in a transaction valued at \$220 million. WNB had about \$1.5 billion in assets.

Prior to WNB, Frost had not acquired a bank since 2006.

The Federal Reserve Board blessed the WNB deal, but as part of the transaction, Frost agreed not to engage in any further expansion activities until it enhanced certain compliance programs, including those related to fair lending to minorities and other underserved populations.

It would be about two years, or in spring 2016, before the Federal Reserve Board would give Frost clearance to pursue acquisitions and other expansion strategies again.

Over the years, Frost executives have been fond of saying they’re “aggressive lookers and conservative buyers.”

Frost is very particular about the banks it buys, studying their culture, how they treat their customers and employees, their banking relationships and assets, Day said.

“Cullen is not a bank that is aggressive when it comes to buying banks,” Winter said. “I think because of the organic revenue opportunities they have, I just don’t see them having pressure to do a deal.”

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