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Heard on the Street
PNC Financial Will Be A Regional No More

By Telis Demos
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[Financial Analysis and Commentary]

PNC Financial Services' acquisition of the BBVA franchise in the U.S. would make its "regional bank" nametag increasingly obsolete. The question is whether that also transforms its profitability.

The $11.6 billion deal agreement flows from PNC's sale of its stake in BlackRock earlier this year, which pulled in $11.1 billion after tax. By paying all cash, PNC is in effect swapping out the BlackRock stake, which generated good returns but didn't add much strategically, for a major expansion of its core business.

Some investors may have been dreaming that a bank with $10 billion to play with could radically rethink the whole concept of banking, perhaps with a huge bet on tech. But many big banks are still finding that core relationship banking and branches, even in a scaled-back form, remain part of the playbook to grow truly profitable customers. That may be particularly so in commercial banking, where PNC will be tilted after the deal.

Instead, investors should think about what PNC is aiming to redefine, which is the "regional bank" appellation. By adding BBVA in places like Texas, the Sun Belt and California to PNC's eastern center of gravity, postdeal the bank would be in 29 of the top 30 U.S. metropolitan statistical areas, up from 22.

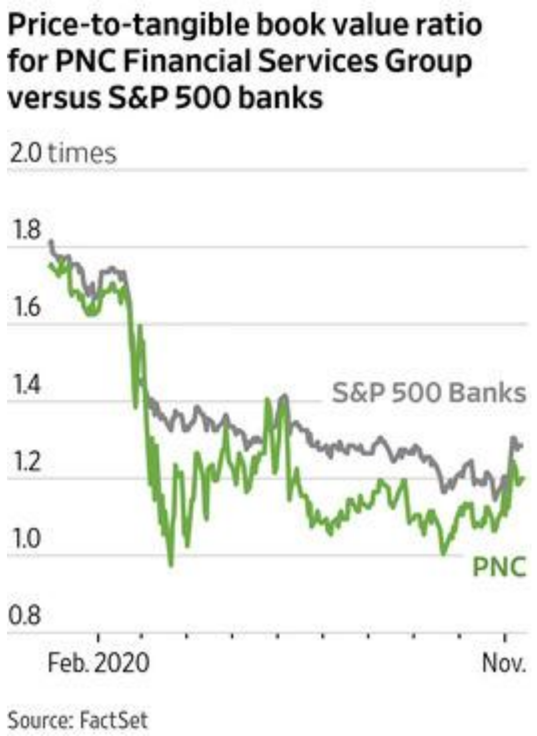
So even if it is a different kind of bank, far more "Main Street" than "Wall Street," it is more national in footprint than Citigroup, for example, along some dimensions. It may also be more national than some peers in asset size among "regionals," such as U.S. Bank or Truist that have regional branch gaps on the East Coast or West Coast, respectively.

Given the government scrutiny of every bank deal, there is further logic to such an expansion. For a bank like PNC already well above a key threshold of $250 billion in assets, its ultimate capital ratio requirements typically depend more on its mix of business than its size. If PNC had added, say, an investment bank with a big trading desk, it might have ended up facing more stringent capital requirements due to its complexity or riskiness than it would by adding a large amount of the same type of banking in more regions.

PNC is betting that the best way to add returns at a time of historically low rates is to bet on applying its operational know-how, including cost reduction and an improved **technology** backbone. It estimates that it can generate a 19% internal rate of return on the deal, which is likely better than banks are typically getting on just deploying their capital in lending these days.

PNC estimates about 21% accretion to its earnings-per-share by 2022. Investors may want to keep an eye on return on equity, too. PNC projects a postdeal return on common equity of 10.5% in 2022. That is about what analysts are projecting for this year, at 10.6%, according to Visible Alpha, and shy of last year at over 11%. But it is still much more than analysts were forecasting for 2022, which is under 10%.

So at a time when returns to risk from lending money are low, the returns to taking business risk are relatively better. That may not be radical, but if well-executed it could still be lucrative.



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PNC Nears $11 Billon Bank Deal

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PNC Financial Services Group Inc. is in talks to buy the U.S. arm of Spain's BBVA for more than $11 billion, according to people familiar with the matter, in one of the largest bank tie-ups since the financial crisis.

A deal would create the fifth-largest U.S. retail bank, with more than $550 billion in assets, a giant in an industry that has been slow to consolidate. It could be announced as soon as Monday, the people said.

Acquiring BBVA's U.S. operations would bolster Pittsburgh-based PNC's presence in fast-growing markets in the Southeast and West. BBVA, which in 2007 bought Alabama-based Compass Bancshares, has about $100 billion of assets in the U.S. with branches across the Sunbelt, including a major presence in Texas. PNC is strongest in the mid-Atlantic, Midwest and Southeast.

PNC Chief Executive Bill Demchak said in September that extending the bank's national presence would be the "first, second and third objective" of any deal.

Big without being deemed too big to grow and with a strong record on takeovers, PNC has long been seen as a likely consolidator of the fragmented U.S. regional banking sector. It stoked that chatter this year when it sold its stake in BlackRock Inc. for $15 billion, bringing in cash that could be redeployed into an acquisition.

Big bank mergers have been rare since the 2008 crisis, with few major players willing to test the political waters and wary of new regulations now applied to larger banks. What is more, the old logic of adding adjacent branch networks is less powerful as digitally savvy consumers are less tethered to their corner branch.

But regional lenders are under pressure from national giants like JPMorgan Chase & Co. and Bank of America Corp., which are raking in deposits with digital apps, big marketing budgets and coast-to-coast branch networks. Low interest rates have hit especially hard at regional banks, which rely more on bread-and-butter loans than rivals with Wall Street arms.

Deals are an obvious solution. By closing branches in overlapping areas and trimming redundant **technology** budgets, regional banks hope to merge their way to higher profits.

In October, First Citizens BancShares Inc. agreed to buy CIT Group Inc. for $2.2 billion, creating a regional bank with more than $100 billion in assets. BB&T Corp. and SunTrust Banks Inc. merged last year into Truist Financial Corp., which is the sixth-largest U.S. retail lender but would be kicked down a notch by a combined PNC-BBVA.

The sheer number of midsize banks in the U.S. has long bred expectations of consolidation in the industry. There are at least 30 lenders with between $50 billion and $250 billion of assets.

The deal wouldn't be PNC's first acquisition of a foreign bank's stateside operations. It bought the U.S. retail banking operations of Royal Bank of Canada in 2012 for $3.45 billion. It also scooped up a handful of struggling institutions during the financial crisis, including National City Corp., which was pushed by regulators to accept a deal.

It would signal a retreat from the U.S. for BBVA, formally called Banco Bilbao Vizcaya Argentaria, Spain's second-largest lender, with a major presence in Latin America, too. It paid about $10 billion in 2007 to acquire Compass, which gave it a long-desired foothold in the U.S., but BBVA has at least twice written down the value of the business and this year warned of another charge as the coronavirus pandemic tore through the U.S. economy. European lenders that planted flags in the U.S. starting in the late 1980s have failed to gain much ground. Royal Bank of Scotland Group PLC sold out of Citizens Financial Group Inc. in 2015. HSBC Holdings PLC said in February it would close a third of its U.S. branches.

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