

## US Market Report Overview

Everybody knows regional banks aren't worth a lot in the market these days, given the issues surrounding their mortgage portfolios. With the buyout of Ohio's **National City Corp.**, regional banks appear to be worth even less than many believed.

On Friday of last week, Pittsburgh-based **PNC Financial Services Corp.** got National City to agree to a take-under, offering \$2.23-a-share in stock, a 19% discount to its previous closing price. The \$5.2 billion deal also includes \$384 million in cash for certain warrant holders.

Despite regional bank valuations being at all-time lows, the National City deal shows that buyers want even lower prices due to continued worries over the potential

landmines on balance sheets. And the U.S. Treasury's bailout plan may also be playing in a role in further below-market deals.

"Most of the take-under deals are being arranged with the regulating agencies," said Charlene Davidson, Senior Managing Director at **McGladrey Capital Markets**. "Until regulators are more comfortable that the situation has been stabilized, they will push more banks to take these deals."

National City had long been the subject of acquisition rumors. After announcing in April that its net income had fallen 87%, National City said it was looking at strategic alternatives and had hired **Goldman Sachs** as its advisor.

### Troubled Banks

Company Name	Price as % of Book Value	Market Value (\$mlns)	Most Recent Loan Loss Provisions (\$mlns)	One Year % Change in Loss Provisions	Tier 1 Capital Ratios
<i>Washington Mutual Inc.</i>	<b>0%</b>	<b>122.8</b>	<b>9,424.0</b>	<b>1455%</b>	<b>7.8</b>
Downey Financial Corp.	5%	46.2	626.0	583%	7.6
FirstFed Financial Corp.	19%	114.8	240.5	3386%	9.5
<i>Sovereign Bancorp Inc.</i>	<b>21%</b>	<b>1,666.2</b>	<b>571.0</b>	<b>120%</b>	<b>6.8</b>
<i>National City Corp.</i>	<b>25%</b>	<b>5,599.0</b>	<b>4,168.9</b>	<b>556%</b>	<b>11.0</b>
<i>Wachovia Corp.</i>	<b>31%</b>	<b>12,309.1</b>	<b>15,027.0</b>	<b>1867%</b>	<b>7.4</b>
Regions Financial Corp.	31%	6,774.2	907.0	360%	7.5
Fifth Third Bancorp	44%	6,537.2	2,204.0	541%	8.5
Huntington Bancshares Inc.	50%	3,082.3	334.9	155%	8.9
Popular Inc.	54%	1,759.0	602.6	175%	10.5
KeyCorp	63%	4,982.3	1,241.0	648%	8.5
Marshall & Ilsley Corp.	64%	4,300.4	1,187.3	1302%	7.9
First Horizon National Corp.	67%	2,118.8	800.0	588%	10.9
Zions Bancorp	70%	3,624.0	363.1	342%	8.1
SunTrust Banks Inc.	71%	12,813.5	1,511.7	391%	8.2
Comerica Inc.	72%	3,908.1	494.0	375%	7.4
Synovus Financial Corp.	82%	2,860.4	336.0	237%	8.8

*Bold Italicized indicate banks that have been sold*

With the prospects of a deal and the hope that National City could right itself, some investors believed National City would be worth more than what PNC is offering. In April, private-equity firm Corsair Capital led a group that bought a nearly 10% stake in National City for \$7 billion. Since June, TPG's hedge-fund unit **Axon Capital** had accumulated a nearly 4% stake in PNC at an average price of around \$2.29-a-share. The most recent mean target price on National City was \$5.65-a-share according to First Call estimates.

Up until recently, National City tried to put forth its best face. In spite of the company's continuing losses, National City CEO Peter Raskind said during the company's most recent earnings conference call that his bank was "strongly capitalized."

But the U.S. Treasury may have seen otherwise. Raskind suggested to analysts that National City was going to apply for additional capital under the U.S. Treasury's Troubled Asset Relief Program. To some, the fact that National City decided to sell means the Treasury was not going to give them additional capital.

By all accounts, PNC is getting a great deal. It paid just 25% of book value for National City. That compares to other regional bank deals of a couple years ago that were done at two or three times book value. PNC also dramatically boosts its market share, going from No. 11 to No 5 largest bank in the U.S. in terms of deposits.

"National City was once considered a stellar institution," Davidson said. "It was considered a very good mid-market bank."

Nor is PNC likely to face a surprise spoiler bid as happened in the fire sale of **Wachovia**. PNC CEO Jim Rohr said the offer was a "competitive bid" against other would-be buyers. **Bank of Nova Scotia** and **U.S. Bancorp**

reportedly also bid on the company during the latest round. Other potential contenders for the bank were **Fifth Third Bancorp** and **KeyCorp**.

And even though Rohr denied the government pushed the deal, the Treasury was definitely in PNC's corner. PNC is selling \$7.7 billion in preferred shares to the Treasury, boosting the capital ratios of the combined bank.

The main worry for any bank acquisition right now involves the balance sheet and the target's loan portfolio. PNC is writing off \$20 billion of National City's \$113 billion mortgage and commercial real estate loan portfolio. That 17.5% reduction, PNC said, was in-line with other recent mark-downs of real estate portfolios.

Still, the marks PNC took against National City's loan portfolio surprised some analysts. An Oppenheimer & Co. report said the "higher-than-expected estimated lifetime losses of National City's loan portfolio does not bode well for future asset quality trends for the regional banks, particularly those losses in the residential construction and non-conforming mortgage/home equity areas."

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