

Mossberg's Investor Digest

Best Idea Profile:

Hilltop Holdings Inc. (NYSE:HTH)

DESCRIPTION:

Hilltop Holdings is a diversified financial holding company that provides banking, mortgage originations, financial advisory, and insurance. Hilltop is the holding company for PlainsCapital Bank, a Federal Reserve member institution providing commercial banking, retail banking, trust, treasury management and wealth management. Hilltop's mortgage origination segment, PrimeLending, generates revenue predominantly from fees charged on the origination of loans and from selling these loans in the secondary market. National Lloyds provides fire and homeowners insurance to low-value dwellings and manufactured homes primarily in Texas and other areas of the southern United States. The financial advisory segment, First Southwest Company, is the smallest segment and earns fees and commissions from investment advisory and securities brokerage services. Hilltop corporate headquarters are in Dallas and it employs more than 4,500 people.

KEY INVESTMENT CONSIDERATIONS:

Small But Dominant – PlainsCapital Bank is the fifth largest Texas-based bank with \$8.8 billion in assets and 78 branches located in all major Texas markets. PrimeLending is the fourth largest mortgage originator in the U.S. with 300 locations in 42 states. First Southwest ranked first nationally and in Texas for the number of public finance issues it completed over the past five years.

Impact of Cost Reductions – PrimeLending revenue plateaued in 2013, following three years of explosive growth. Although the largest generator of Hilltop's revenues, its low margins required attention. Therefore, headcount was reduced and other operating costs were lowered to address the slowdown in the mortgage market. In late 2013 PlainsCapital Bank acquired substantially all of the liabilities and assets of Edinburg, Texas-based First National Bank from the Federal Deposit Insurance Corporation, including numerous non-performing loans. It is closing many of these branches in the Texas Valley that it acquired, which will reduce expenses by about \$5.5 million. In fact approximately 91% of the noninterest expense increase in the 2014 third quarter was because of the FNB transaction. This also contributed to the Other Real Estate Owned write-downs, along with the expenses of the branches slated to close. Management confirmed that the big OREO write-downs are now behind the company.

Impactful Acquisition of SWS Group, Inc. – Hilltop announced an agreement to acquire SWS Group, Inc. in March 2014 and will ask for shareholder approval on November 21. Hilltop already owns 21% of the shares. The transaction will create the largest full service brokerage firm headquartered in the southwestern U.S., fortifies its strong presence in Texas, and adds complementary offices elsewhere. There is much overlap in types of business with Hilltop's existing business but adds other types of business, significant operating synergies and efficiencies. Importantly, Hilltop will be well equipped with excess cash to continue its stated intent to make additional acquisitions. The deal is expected to close the deal by year end.

Small Exposure to Oil and Gas – Less than 5% of Hilltop's loan base is oil and gas related, which gives it an advantage over financial institutions with significant negative exposure created by the fall in energy prices.

VALUATION:

A regional bank of this quality and with an admirable growth trajectory should warrant a higher multiple than is afforded Hilltop Holdings. Management and other impressive long-term shareholders hold significant positions, with insider ownership at 25%.

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Investment Data (as of 11/11/14)

Recent Price	\$21.18
52-Week Range	\$17.16 - \$25.61
Fiscal Year End	Dec
Dividend	NA
Yield	NA
Shares Outstanding	90 M
Average Trading Volume (3 mos)	230k
Market Capitalization	\$1.9 B
Cash	\$714 M
Long-term Debt	\$1.1 B
Enterprise Value (EV)	\$2.5 B
Book Value	\$14.22
TTM Revenue	\$1.1 B
P/ Revenue	1.8x
TTM EPS	\$1.34
P/ EPS	15.8x
TTM EBITDA	NA
EV/ EBITDA	NA

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