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Central Pennsylvania: Back to Its Roots

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After nearly twenty years of intrastate and interstate banking, in both the highly urbanized South Central Pennsylvania* and sparsely populated Upper Susquehanna region,** the banking structure has maintained its uniqueness and strong local flavor. This is particularly the case in the Upper Susquehanna where two of the state's banking leaders, First Union and Mellon, have pretty much come and gone. The leader in each sector is an out-of-state bank, but in neither case is it a truly large bank, and the permanence of their leadership positions are far from secure.

While Central Pennsylvania's continued strong local banking content is reminiscent of what banking use to be, the region has had as much merger activity and consolidation as any other. The difference is that the end result of merger activity has had more impact on signage than on the industry structure.

In the Upper Susquehanna, for example, there are branch offices originally opened by small banks that have been part of as many as six banking organizations and are again part of small local banks. Their odyssey began as a result of being acquired by Commonwealth in the eighties and continued when Commonwealth was bought by Meridian, which was later acquired by CoreStates and then shortly thereafter, CoreStates was taken over by First Union. The latter, as part of the CoreStates transaction, sold the Upper Susquehanna branches to Sovereign, and if that was not enough, Sovereign has since sold many of these offices to local banks.

*Adams, Cumberland, Dauphin, Franklin, Lancaster, Lebanon, Perry and York counties.

**Bradford, Clinton, Columbia, Juniata, Lycoming, Mifflin, Montour, Northumberland, Potter, Snyder, Sullivan, Tioga and Union counties.

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South Central Pennsylvania

Nothing quite this dramatic has happened in South Central Pennsylvania, but a similar pattern is evident in that extensive acquisition activity seems likely to result in only minimal change in the industry structure – i.e., most of the banking leaders being local with market shares in the low teens. This was not the way it looked early on, though. In 1969, one of the first multi-county mergers in Pennsylvania joined together banks in Harrisburg, Lancaster and York to form Commonwealth National and create the second largest bank in the region, and when it was sold to Mellon, a regional takeover by some large outsiders seemed inevitable. This, though, was not to be.

The resilience of local banks in South Central Pennsylvania is reflected in many of the structural changes since 1970. Among the more interesting are that:

- The largest bank in the region in 1970, National Central, had a higher share of area deposits at that time than the leader in 2000, Allfirst, despite the geographic restrictions in the earlier period – i.e., 16.3% to 12.9%.
- Each of the last three decades started with a new number one – National Central in 1980, Dauphin Deposit in 1990 and Allfirst in 2000 – and this is likely to be true in 2010 with the most realistic candidates being local banks.
- Fulton and Waypoint - a.k.a. Harris Savings - are the only members of the 1970 leaders around in 2000, but they rank second and third in deposit share; and Fulton would appear to be on its way to becoming number one.
- Mellon did not abandon the area after its Commonwealth National acquisition, but it is no longer near the top of the “pecking order” with only the eighth largest South Central Pennsylvania deposit share.
- CoreStates buying the area’s largest bank, National Central, ended up turning a one time leader into a diminishing factor.

Thirty Years of South Central Pennsylvania* Banking Leaders

	<u>Deposits</u>	<u>Market</u>		<u>Deposits</u>	<u>Market</u>
	<u>(In mill.)</u>	<u>Share</u>		<u>(In mill.)</u>	<u>Share</u>
<u>2000</u>			<u>1990</u>		
1. Allfirst	\$ 3,044	12.9%	1. Dauphin Deposit	\$ 1,932	9.6%
2. Fulton	2,625	11.1	2. CoreStates	1,691	8.4
3. Waypoint	2,452	10.4	3. Fulton	1,254	6.2
4. First Union	1,909	8.1	4. York Bank	1,193	5.9
5. Sterling	1,285	5.5	5. Mellon	1,190	5.9
6. PNC	1,229	5.2	6. Meridian	1,079	5.4
7. Susquehanna	1,083	4.6	7. CCNB	976	4.8
8. Mellon	921	3.9	8. Harris Savings	785	3.9
9. M&T	876	3.7	9. Susquehanna	766	3.8
10. Community Banks	616	2.6	10. York Federal	612	3.0
11. ACNB	458	2.0	11. Farmers B&T	461	2.3
12. Penn Rock	429	1.8	12. Sterling Financial	367	1.8
Total	\$16,927	71.8%	Total	\$12,306	61.0%
<u>1980</u>			<u>1970</u>		
1. National Central	\$ 1,114	12.2%	1. National Central	\$ 512	16.3%
2. Commonwealth Nat'l.	865	9.5	2. Commonwealth Nat'l.	354	11.3
3. Dauphin Deposit	504	5.5	3. Dauphin Deposit	236	7.5
4. York Bank	407	4.5	4. York Bank	149	4.7
5. Fulton	395	4.3	5. Fulton	130	4.1
6. First Fed.-Harrisburg	359	3.9	6. CCNB	101	3.2
7. York Federal	318	3.5	7. Southern Penn. Bank	80	2.5
8. Harris Savings	269	3.0	8. Lebanon Valley Farmers	64	2.0
9. State Capital S&L	256	2.8	- First Fed.-Harrisburg	N/A	N/A
10. CCNB	239	2.6	- York Federal	N/A	N/A
11. Susquehanna	215	2.4	- Harris Savings	N/A	N/A
12. Southern Penn. Bank	196	2.2	- State Capital	N/A	N/A
Total	\$ 5,137	56.4%			

*Adams, Cumberland, Dauphin, Franklin, Lancaster, Lebanon, Perry and York counties.

Source: Various sources.

One does not have to go back thirty years, though, to see changes in the area's banking and recent trends also suggest a decrease in concentration and a diminishing of the position of out-of-area banks. Allfirst, First Union/CoreStates and Mellon have all lost substantial deposit share in recent years. Only PNC of the large out-of-area banks has gone counter to this trend.

Allfirst, a holding company based in Baltimore that is owned by an Irish bank, was the market leader by a large margin in 1998 after adding Dauphin Deposit to its earlier York Bank acquisition, and it has had the biggest declines. Its share of deposits fell from 18.4% in 1998 to 12.9% in 2000, which narrowed its advantage over Fulton from about nine to less than two percentage points. Much of the slippage is the transfer of deposits from the Dauphin Deposit main office in Harrisburg to the Baltimore, but even if the decline in main office deposits was excluded, Allfirst's deposit share would have slipped by 2.8 percentage points during this period.

The First Union figures are harder to follow as it grossly understated its area deposits in 1998 and 1999, but its 2000 deposit share was only marginally down from 1998 if a normal progression is assumed between what was reported in 2000 and by its predecessor, CoreStates, in 1997. It is a decline of two percentage points, though, from what CoreStates held in 1996.

Mellon, which was the second largest bank in the region after acquiring Commonwealth National, had slipped to fifth place in South Central Pennsylvania by 1996, and it has been downhill ever since. It was sixth in 1998; seventh in 1999; and eighth in 2000.

M&T is another large, out-of-area bank with a diminishing franchise. It is different from its brethren, though, in that its 3.7% deposit share came through the acquisition of Keystone Financial, and the deposit share slippage occurred prior to the acquisition.

South Central Pennsylvania Deposit Share*

	Deposits 2000 (In mill.)	Market Share			
		June 30,			
		2000	1999	1998	1996
<u>Market Leaders</u>					
Allfirst	\$ 3,044	12.9%	14.9%	18.4%	4.1%
Fulton	2,625	11.1	8.7	9.1	6.7
Waypoint	2,452	10.4	5.1	4.5	5.3
First Union**	<u>1,909</u>	<u>8.1</u>	<u>8.2</u>	<u>8.2</u>	<u>10.1</u>
Subtotal	\$10,030	42.5%	36.9%	40.2%	26.2%
<u>Other Large</u>					
Sterling	\$ 1,285	5.5%	3.4%	3.3%	2.9%
PNC	1,229	5.2	4.9	4.8	5.4
Susquehanna	1,083	4.6	4.5	4.0	4.1
Mellon	921	3.9	4.0	4.4	4.6
M&T***	876	3.7	3.9	4.4	.5
Community Banks	616	2.6	1.8	1.5	.6
ACNB	458	2.0	2.0	1.8	1.9
PennRock	429	1.8	1.7	1.4	1.4
Northwest	406	1.7	1.6	1.4	1.0
Commerce	388	1.6	1.4	1.1	.7
Franklin Financial	339	1.5	1.4	1.3	1.2
Ephrata National	315	1.3	1.3	1.2	1.1
Codorus Valley	243	1.0	1.0	1.0	1.0
Union National	216	.9	.9	.8	.7
Orrstown	213	.9	.8	.8	.6
Mid Penn	<u>179</u>	<u>.8</u>	<u>.7</u>	<u>.6</u>	<u>.6</u>
Subtotal	\$ 9,196	39.0%	35.3%	33.8%	28.3%
Other Banks	\$ 1,343	5.7%	10.0%	9.4%	23.6%
Other Thrifts	235	1.0	6.0	5.9	11.8
Credit Unions	<u>2,784</u>	<u>11.8</u>	<u>11.8</u>	<u>10.7</u>	<u>10.1</u>
Total	\$23,588	100.0%	100.0%	100.0%	100.0%

*Adams, Cumberland, Dauphin, Franklin, Lancaster, Lebanon, Perry and York counties.

**CoreStates as a continuing factor and adjusted for 1999 and 1998.

***Keystone as a continuing factor.

Source: SNL Securities LC, Charlottesville, Virginia.

Major benefactors of the declining stature of the out-of-area banks were Fulton, Waypoint and Sterling. Fulton, helped by its acquisitions of Keystone Heritage and Drovers, has lifted its share of the region's deposits from 6.7% in 1996 to 11.1% in 2000. Waypoint, which is the new name for the recently combined Harris Savings and York Federal, doubled the share of Harris with the merger, and became a third player with a double-digit deposit share. Sterling jumped from ninth in 1998 to fifth in 2000, primarily through the acquisition of Hanover Bank.

Almost all of the smaller banks in the market have increased their share of deposits in the last couple of years, and, in most cases, it was through internal growth. The biggest increases were by Community Banks and Commerce. The former, with some help from acquisitions, moved from a .6% deposit share in 1996 to a 2.6% share in 2000. South Central Pennsylvania's Commerce Bank increased its share from .7% to 1.6% over the same period entirely through internal growth.

Upper Susquehanna

The northern portion of Central Pennsylvania, referred to in this report as the Upper Susquehanna, is demographically very different from South Central Pennsylvania. While the southern sector is highly urbanized, one of the fastest growing markets in the Northeast and a major agricultural center, the Upper Susquehanna is sparsely populated, experiencing little in the way of growth and, for the most part, not conducive to extensive agricultural activities. Of course, this may be another way of saying the Upper Susquehanna has an ambience and life style that will eventually bring growth, wanted or not, to the region.

The outlying rural aspects of the Upper Susquehanna can be seen in its banking structure, particularly when taking a thirty year perspective. In 1970, the largest bank in the region, Williamsport-based Northern Central, had only \$70 million in deposits, and Snyder County Trust Company, the forerunner of Sun Bancorp, made it into the top twelve with just \$24 million deposits. In South Central Pennsylvania, the banking leader with a similar sounding name, National Central, had deposits in excess of \$500 million.

Thirty Years of Upper Susquehanna* Banking Leaders

	<u>Deposits</u> (In mill.)	<u>Market</u> <u>Share</u>		<u>Deposits</u> (In mill.)	<u>Market</u> <u>Share</u>
<u>2000</u>			<u>1990</u>		
1. M&T	\$1,006	14.5%	1. Commonwealth	\$ 844	14.4%
2. Citizens & Northern	501	7.2	2. Keystone	753	12.9
3. Fulton	452	6.5	3. Susquehanna	380	6.5
4. Susquehanna	450	6.5	4. Citizens & Northern	319	5.5
5. Sun	440	6.4	5. Mellon	204	3.5
6. Sovereign	411	5.9	6. Central Penn. Savings	202	3.5
7. Citizens Financial	366	5.3	7. First Eastern	169	2.9
8. Juniata Valley	244	3.5	8. Omega	151	2.6
9. Penns Woods	243	3.5	9. Penn Woods	121	2.1
10. Northwest	209	3.0	10. Columbia Financial	118	2.0
11. First Keystone	202	2.9	11. First Nat'l.-Bradford	114	1.9
12. Omega	174	2.5	12. Juniata Valley	113	1.9
Total	\$4,698	67.7%		\$3,508	59.7%
<u>1980</u>			<u>1970</u>		
1. Northern Central	\$ 279	8.9%	1. Northern Central	\$ 70	5.9%
2. Commonwealth	183	5.8	2. Williamsport National	51	4.3
3. Fidelity National	142	4.5	3. Fidelity National	50	4.2
4. First National Trust	114	3.6	4. Commonwealth	47	3.9
5. Citizens & Northern	112	3.6	5. Russell National	37	3.1
6. Williamsport National	107	3.4	6. First National Trust	37	3.1
7. Central Counties	97	3.1	7. Tri-County National	32	2.7
8. Russell National	97	3.1	8. Northern National	28	2.4
9. Bank of Central Penn.	82	2.6	9. Lock Haven Trust	26	2.2
10. Tri-County National	78	2.5	10. Juniata Valley	25	2.1
11. First Eastern	75	2.4	11. First Nat'l.-Lock Haven	24	2.0
12. Central Penn. Svgs.	75	2.4	12. Snyder County Trust	24	2.0
Total	\$1,441	45.9%	Total	\$ 451	37.9%

*Bradford, Clinton, Columbia, Juniata, Lycoming, Mifflin, Montour, Northumberland, Potter, Snyder, Sullivan, Tioga and Union counties.

Source: Various sources.

Williamsport is the largest city in the Upper Susquehanna, and this is reflected in the region's banking structure. In 1970, three Williamsport banks – Northern Central, Williamsport National and Fidelity National - were the biggest banks in the market, and Commonwealth, which was number four, was in nearby Muncy, but with county branching restrictions, these banks only held about 18% of the region's deposits.

The seventies saw considerable merger activity, but there was little change in the overall banking structure. Williamsport banks extended their coverage, but still had only 23% of the region's deposits. The biggest change in Upper Susquehanna in the seventies came from the combining of Northern National of Wellsboro, First National of Ralston and Citizens National of Towanda into Citizens & Northern, which would be the fifth largest bank in the region in 1980 and second largest in 2000.

In 1984, major changes came to the area as an equal merger between the region's largest bank, Northern Central, and Mid-State of Altoona created Keystone Financial and seemed to open the floodgates. Shortly thereafter, Susquehanna acquired Williamsport National and First National Trust, and the second largest Williamsport bank, Commonwealth, went on an acquisition spree that tripled its size and made it the region's largest bank by 1990. When "the dust settled," Keystone and Susquehanna ranked second and third in the Upper Susquehanna. Mellon also acquired its way into the region in the mid-eighties and ranked fifth in deposit share in 1990.

While the eighties were a period of change in the Upper Susquehanna as banks wanted "in," the nineties were a period of change because banks, some of which entered by accident, wanted "out." The big "accident" was CoreStates becoming a regional leader as a result of its acquisition of Meridian, which had come into the market through its acquisition of the market leader at that time, Commonwealth. First Union then acquired CoreStates, and as part of that transaction sold the acquired branches in the region to Sovereign, which has subsequently again sold many of these branches.

Upper Susquehanna Deposit Share*

	Deposits 2000 (In mill.)	Market Share			
		June 30,			
		2000	1999	1998	1996
<u>Market Leaders</u>					
M&T**	\$1,006	14.5%	14.2%	14.7%	14.6%
<u>Second Tier</u>					
Citizens & Northern	\$ 501	7.2%	7.2%	7.4%	6.3%
Fulton	452	6.5	6.7	7.0	6.7
Susquehanna	450	6.5	6.8	7.1	6.7
Sun	440	6.4	4.7	4.6	3.2
Sovereign	411	5.9	8.9	-	-
Citizens Financial	366	5.3	4.2	4.0	3.7
Subtotal	\$2,620	37.8%	38.5%	30.1%	26.6%
<u>Other Large</u>					
Juniata Valley	\$ 244	3.5%	3.7%	2.4%	2.2%
Penns Woods	243	3.5	3.4	3.4	3.2
Northwest	209	3.0	1.2	.8	.6
First Keystone	202	2.9	2.6	2.6	2.3
Omega	174	2.5	2.5	2.8	3.2
PNC	167	2.4	2.3	2.4	2.9
Kish Bank	156	2.3	2.1	2.0	1.7
Mifflinburg	155	2.3	2.3	2.3	1.7
Columbia Financial	148	2.2	2.2	2.1	2.1
CCFNB	141	2.0	2.1	2.0	2.0
West Milton	125	1.8	1.8	1.9	1.8
First Community	99	1.4	1.4	1.3	1.1
Woodlands	94	1.4	1.3	1.1	.9
Peoples	94	1.4	1.5	1.4	1.2
Subtotal	\$2,251	32.6%	30.4%	28.5%	26.9%
Other Banks	\$ 594	8.6%	10.2%	20.7%	26.0%
Other Thrifts	148	2.1	2.2	1.9	1.8
Credit Unions	307	4.4	4.5	4.1	4.1
Total	\$6,926	100.0%	100.0%	100.0%	100.0%

*Bradford, Clinton, Columbia, Juniata, Lycoming, Mifflin, Montour, Northumberland, Potter, Snyder, Sullivan, Tioga and Union counties.
 **Keystone as a continuing factor.

Source: SNL Securities LC, Charlottesville, Virginia.

One of the other two big banks that had a presence in the nineties, PNC, also came in by accident. PNC entered when it acquired Wilkes-Barre-based First Eastern, which had branches in the Upper Susquehanna. PNC is still there, but with a diminished market share. Mellon entered through a small mid-eighties acquisition, but has since sold most of its branches in the region.

With Mellon and PNC aborting their entry into the Upper Susquehanna and Sovereign selling much of the position it bought from First Union, by the start of the 2000's, most of the out-of-area ownership came from neighboring counties to the south. Keystone had the region's largest deposit share; Fulton ranked fourth; and Susquehanna was fifth. The latter duo had shares similar to three Upper Susquehanna banks that had become substantial regional forces – Citizens & Northern, Sun and Citizens Financial. Despite all the mergers, though, as 2000 began, only Keystone had more than a 9% deposit share.

The new decade was hardly a month old when a major change occurred with Keystone announcing its sale to a \$30 billion Upstate New York bank, M&T. For the first time, the Upper Susquehanna's largest bank came from outside Central Pennsylvania, and, though, it is unlikely it would have acquired Keystone if it did not want to be in rural, small town markets, only time will tell whether this is a lasting interest.

The deposit share trends of the last couple of years also show a gradual growth of local banks at the expense of the large and mid-size regionals, and when branch sales occur, the pattern is more than gradual. In the most recent years, Keystone, Fulton, Susquehanna, Omega and PNC all have had modest deposit share losses, and Mellon and Sovereign, because of branch sales, have had large share declines. Conversely, Sun, Citizens Financial, Juniata Valley, Kish, Mifflinburg Bank & Trust and Woodlands have had good share gains, and no local bank with more than \$90 million deposits has lost share.

The only exception to the outsider loss of position is Northwest Savings. It recently bought branches in the region from Sovereign.

Looking Forward

What can be expected in the future relative to South Central Pennsylvania and Upper Susquehanna banking? The obvious answer is surprises. Ten years ago no one would have guessed that the market leader in South Central Pennsylvania would be an Irish-owned bank; the leader in the Upper Susquehanna would be a Buffalo bank few had ever heard of; the Meridian, Commonwealth, CoreStates and Fidelcor franchises would all be part of First Union; or that Mellon would be pulling out rather than expanding.

Beyond surprises, though, it is likely that for the next few years present trends will continue. First Union, Mellon and Allfirst should continue to lose share; Fulton, Susquehanna and PNC are likely to at least hold their present positions; and the local banks will gain share in sub-markets where the large banks have a presence.

For First Union and Mellon, the loss of share is virtually a given. First Union is a struggling bank that is cutting costs throughout its system, and Mellon is far more committed to asset management than retail banking, which accounts for only 18% of its profits. PNC is headed in the same direction as Mellon, and it would seem to be only a matter of time before it cuts back coverage in areas where it is not a market leader.

It is not what these big banks do, though, that will have the biggest impact on the banking structure in Central Pennsylvania, but rather the decisions of two out-of-area mid-sized banks, Allfirst and M&T, and the locally-based regionals, Fulton, Susquehanna and Waypoint. They are all committed to the region, but a couple of years ago the same could have been said about Keystone. The past suggests there will be at least one big merger involving these banks in the next couple of years.

M&T, a new entrant through its purchase of Keystone, may be the most predictable of these banks. As a \$30 billion bank with most of its deposits in markets of little interest to larger banks, it is not likely to be acquired, and the purchase of Keystone suggests it will expand in South Central Pennsylvania if given the opportunity. If Fulton, Susquehanna, Waypoint or even Allfirst were to contemplate selling, M&T is likely to be an interested buyer.

The least predictable is Allfirst since it is dependent on decisions made in Europe, and with the consolidation that is taking place in banking worldwide what

happens in Central Pennsylvania is hostage to moves elsewhere. In the last year alone, the National Bank of Australia sold its Michigan subsidiary and ABN AMRO sold its New York City banking office. As long as Allfirst is around, though, it also is a potential acquirer of banks in South Central Pennsylvania.

A “wild card” in Central Pennsylvania is BB&T. It has not ventured north of the Mason-Dixon line, but it has spent about \$500 million to buy banks in Maryland counties that border Pennsylvania, and with Summit gone, it is the outsider most likely to have an interest in Central Pennsylvania. BB&T is a \$60 billion bank that likes small town banking, and if Allfirst, Fulton, Susquehanna or Wayfirst were to sell, it could have an interest.

Another bank that could have a big future impact is Commerce. It is a growing factor in South Central Pennsylvania and has tripled its size in the last five years. If it were to do so again in the next five, it would have \$1.2 billion deposits by 2006. This is high growth, but judging by what Commerce has done in the Philadelphia area, it would seem doable.

No matter who buys whom, banking in South Central Pennsylvania and Upper Susquehanna will be moving in different directions. Despite the reduced positions of Mellon and First Union in both markets, size and population density will eventually create a banking structure in South Central Pennsylvania that is similar to that of Philadelphia to the east and Baltimore to the south. In Upper Susquehanna, the large banks will limit their interest to remote access.

It is not hard to picture a banking elite five years from now in South Central Pennsylvania that includes Bank of America, BB&T, M&T, Allfirst and one of the existing local regionals. If Bank of America is not the acquirer of a struggling First Union, then substitute Wells Fargo or Fleet.

In Upper Susquehanna, M&T may be as big as leaders get, and out-of-area owned local banking offices could be further reduced if Susquehanna or Fulton were sold. Thus, instead of a market dominated by Bank of America or Mellon, it is possible come 2005 or 2010, the largest deposits shares could belong to M&T, Sun, Citizens & Northern and Citizens Financial.